



BANK OF ENGLAND

Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 31 October 2018

Publication date: 1 November 2018

These are the minutes of the Monetary Policy Committee meeting ending on 31 October 2018.

They are available at <https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2018/november-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 19 December will be published on 20 December 2018.

Monetary Policy Summary, November 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 31 October 2018, the MPC voted unanimously to maintain Bank Rate at 0.75%. 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 November *Inflation Report*. In the Committee's central projection, conditioned on the gently rising path of Bank Rate implied by market yields and on a smooth adjustment to the average of a range of possible outcomes for the United Kingdom's eventual trading relationship with the European Union, GDP is expected to grow by around 1¾% per year on average over the forecast period. Momentum in household consumption appears greater than previously expected, supported by the strong labour market and resilient household confidence. Over the forecast period, household consumption is expected to grow modestly relative to historical rates, broadly in line with real incomes. In contrast, business investment has been more subdued than previously anticipated, as the effect of Brexit uncertainty has intensified. Under the smooth transition assumption on which the forecast is conditioned, greater clarity is expected to emerge over the coming months, boosting investment growth. The MPC's projections were finalised before the Budget measures had been announced and the Committee will assess the implications at its next meeting.

The global economy continues to grow at above potential rates, supporting UK net trade. Growth has softened, however, and become more uneven across countries, and downside risks have risen. Global financial conditions have tightened, particularly in emerging market economies, and activity has slowed in the euro area. Trade restrictions have increased and there is a risk of further escalation.

The MPC judges that aggregate supply and demand are now broadly in balance. The labour market remains tight, with the employment rate and vacancies around record highs, and the unemployment rate at its lowest since the mid-1970s. Regular pay growth has been stronger than expected, rising to over 3%. Although modest by historical standards, the projected pace of UK GDP growth is slightly faster than the diminished rate of supply growth, which averages around 1½% per year. A margin of excess demand is therefore expected to build, feeding through into higher growth in domestic costs. The contribution of external cost pressures, which has accounted for above-target inflation since the beginning of 2017, is projected to ease over the forecast period. Taking these influences together, CPI inflation is projected to remain above the target for most of the forecast period, before reaching 2% by the end of the third year.

The economic outlook will depend significantly on the nature of EU withdrawal, in particular the form of new trading arrangements, the smoothness of the transition to them and the responses of households, businesses and financial markets. The implications for the appropriate path of monetary policy will depend on the balance of the effects on demand, supply and the exchange rate. The MPC judges that the monetary policy response to Brexit, whatever form it takes, will not be automatic and could be in either direction.

At this meeting the MPC judged that the current stance of monetary policy remained appropriate. The Committee also judges that, were the economy to continue to develop broadly in line with the November *Inflation Report* projections, an ongoing tightening of monetary policy over the forecast period would be appropriate to return inflation sustainably to the 2% target at a conventional horizon. 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 31 October 2018

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

Financial markets

2 In the period since the Committee's September meeting, global financial conditions had tightened somewhat, with risky asset prices falling globally. On 26 September, the FOMC had announced a 25 basis point increase in the target range for the federal funds rate. US longer-term interest rates had risen slightly. The FTSE All Share, S&P 500 and EuroStoxx equity indices had each fallen by around 5%, and equity implied volatility had picked up. Sterling, euro and US dollar high-yield corporate bond spreads had increased. In emerging markets, equity prices had also fallen, although other asset price movements had been mixed, in part reflecting idiosyncratic political developments. Market contacts had pointed to higher US interest rates and trade tensions as factors reducing risk sentiment.

3 The conditioning path for Bank Rate underpinning the November *Inflation Report* projections had been steeper than in August, with three-year instantaneous forward OIS rates around 20 basis points higher. More recently, short-term interest rates had declined to levels slightly lower than at the time of the Committee's August and September meetings. Ten-year gilt yields were also a little lower than at the time of the Committee's September meeting, although market-implied measures of inflation compensation on sterling assets had increased a little. The announcement by the Italian government of its fiscal plans, and subsequent exchanges with the European Commission, had led to increases in the spread of Italian government bonds to German Bunds.

4 The sterling exchange rate index had fallen by 1% since the MPC's previous meeting, although the November *Inflation Report* conditioning path was around 1% higher than in August. Sterling had continued to be sensitive to developments relating to the UK's withdrawal from the European Union. Sterling-dollar implied volatility had remained elevated, and sterling-dollar 6-month risk reversals had fallen to their lowest levels in the post-referendum period, suggesting an increase in perceived downside risks to the exchange rate.

The international economy

5 Although the global economy had continued to grow above trend, the recent data had been, in general, weaker than expected at the time of the August *Inflation Report*. Financial conditions had continued to tighten in emerging markets, trade tensions had become increasingly apparent in survey data, and oil prices had risen further, largely reflecting supply developments. Set against that, there had been upside news on recent activity in the United States.

6 Euro-area GDP growth had weakened further, from 0.4% in each of the first two quarters of the year, to 0.2% in the preliminary estimate for Q3. This was 0.3 percentage points weaker than had been expected by Bank staff at the time of the *August Report*, and well below the 0.7% average quarterly growth rate recorded in 2017. High-frequency indicators had nevertheless painted a somewhat stronger picture. Industrial production had increased strongly in August, reversing the persistent weakening seen since the beginning of the year, while remaining below the levels seen in 2017. The PMIs had been stable in 2018 Q3, although they had fallen again in October. Bank staff judged that quarterly growth would recover somewhat in the fourth quarter.

7 According to the advance estimate, US GDP had grown by 0.9% in 2018 Q3, down from 1.0% in Q2. This was 0.1 percentage points higher than expected at the time of the *August Inflation Report*, reflecting stronger household consumption and greater stockbuilding, offset by lower contributions from net trade and investment. Some of this momentum looked likely to continue into the fourth quarter, with consumer spending supported by the strong labour market and the unemployment rate having fallen in September to 3.7%, the lowest since 1969. Although overall consumer confidence had remained at very high levels, nearly one third of consumers surveyed in September had expressed concerns about the negative impact of tariffs. Similarly, the Q3 Conference Board survey of CEOs had suggested that trade tensions were weighing on sentiment, with confidence falling to its lowest level in two years.

8 In China, GDP had grown by 6.5% in the year to 2018 Q3, down from 6.7% in Q2 and slightly below expectations. Higher-frequency indicators had shown a mixed picture. Annual growth in industrial production had fallen to 5.8% in September, from 6.1% in August, and Bank staff's estimate of quarterly growth looked to have been particularly weak in Q3. Fixed asset investment growth had remained at low levels. But growth of retail sales and exports had been higher than expected. The United States had implemented its second round of tariffs on \$200 billion of imports from China, at a rate of 10%, which looked set to weigh on activity. The Chinese authorities had loosened policy further, with an additional 100 basis point cut in the reserve requirement ratio bringing the total reduction for the year to date to 250 basis points. The renminbi had depreciated against the US dollar by around 10% since the beginning of April.

9 In other emerging markets, tighter financial conditions were weighing on the outlook for growth. There had, however, been limited evidence as yet that this had actually led to a material slowdown in activity, except in Turkey and Argentina, the two countries most directly affected by the market turbulence. In 2018 Q2, GDP growth had been mixed across major emerging markets. In Q3, PMIs had weakened slightly across emerging markets as a whole, suggesting that GDP growth would be a touch weaker than in the previous quarter.

10 Global survey indicators had suggested that trade tensions were starting to weigh on the global economic expansion more generally. The JP Morgan global manufacturing output and new orders PMIs had both fallen in September to their lowest levels for around two years. This had been less evident in the hard data as yet. On a 3-month-on-3-month comparison, growth in world goods trade had picked up in August, to 1.5%, although world industrial production growth had, for the seventh successive month, either fallen or been flat.

11 The Brent oil spot price had ended the period 4% lower than at the time of the MPC's previous meeting. Over most of the month, oil prices had been higher, reflecting concerns over supply disruptions, in particular

related to US sanctions on Iran and uncertainty about the ability of other large oil producers to compensate for the reduction in supply that was likely to ensue. More recently, prices had fallen sharply after Saudi Arabia had pledged to cover any shortfall.

12 The increase in oil prices in recent months had pushed up on headline inflation. In the United States, annual headline PCE inflation had been 2.0% in September, although it had fallen slightly on the month, while the core measure had been at 2.0% for the fifth consecutive month. In the euro area, annual headline HICP inflation had been 2.2% in October, remaining above the ECB's price stability objective. Core inflation had remained relatively weak in October at 1.1%.

Money, credit, demand and output

13 UK GDP was reported to have grown by 0.7% in the three months to August, a little stronger than had been expected at the time of the *August Inflation Report*. Although services output had slowed, the contribution of production had turned positive, while construction output growth had remained solid. Bank staff now expected GDP growth to have been around 0.6% in Q3, 0.2 percentage points higher than the forecast at the time of the *August Inflation Report*.

14 It seemed likely, however, that Q3 output growth in some sectors had been boosted somewhat by temporary factors, with construction and manufacturing having recovered from weakness earlier in the year, and a weather-related boost to retail output. A more modest pace of expansion, of around 0.3%, was expected in Q4. This would be consistent with the recent readings from a range of business surveys.

15 Revised official data had suggested that household consumption growth had been stronger in 2018 H1 than previously thought. Recent indicators of consumer demand had pointed to a similar pace of growth in H2 as seen in H1. Retail sales had grown by 1.2% in Q3, compared with 1.9% in the three months to August. This softening in growth had been expected, as the supportive effects of unseasonably good weather unwound. Consumer confidence indicators had fallen or been unchanged in the latest readings, but had remained at or above their historical averages. The SMMT had reported a marked drop in vehicle registrations in September. Market intelligence suggested that this was related to the introduction of the Worldwide Harmonised Light Vehicle Test Procedure, and should consequently not be taken as a signal of household sentiment. Nevertheless, it was possible that this development would cause vehicle spending to drag on consumption growth temporarily in Q3.

16 House price inflation had edged up slightly. The UK House Price Index had risen at an annualised rate of 4.2% in the three months to August, having been below 2% in the three months to May. Housing transactions and loan approvals for house purchase had remained steady.

17 Consumer credit had been weak in September. This reflected a fall in dealership car finance, consistent with the drop in vehicle registrations; but even abstracting from this, consumer credit had softened in Q3. It was possible that this reflected a weakening in credit demand, although the Bank's *Credit Conditions Survey* had reported a marginal tightening in the availability of credit.

18 On the latest official data, business investment had fallen in both 2018 Q1 and Q2, and the near-term outlook appeared subdued. There had been signs of a step-up in uncertainty among businesses regarding the Brexit process and the effects of that uncertainty on activity. The Bank's Decision Maker Panel Survey had found that more than 50% of firms identified Brexit as being in their top three sources of uncertainty in September and October, a rise of around ten percentage points from the survey in August. Respondents to the 2018 *Deloitte CFO Survey* viewed Brexit as the biggest risk facing their business, on average, with sentiment towards its long-term impact turning increasingly negative. It was likely that this uncertainty was dragging on business investment: both the Bank's Agents and the CBI *Quarterly Industrial Trends Survey* had reported a decline in investment intentions in October. The Bank's Agents had conducted a special survey of UK companies' investment intentions, and their contacts had reported that Brexit uncertainty was the biggest headwind to investment.

19 There had been little evidence to date of any significant precautionary stockbuilding ahead of Brexit. If concerns about a disorderly Brexit were to persist, it was possible that such stockbuilding could occur in 2018 Q4 and 2019 Q1. Nevertheless, there were reasons to expect any effects on aggregate activity to be limited. Many of the goods being stockpiled would be imported, in which case stockbuilding would be neutral for GDP; there were likely to be constraints on warehouse capacity and haulage that would limit the feasibility of substantial inventory accumulation; and companies that process seasonal or perishable goods were likely to delay stockbuilding as long as possible. There was also little evidence of a boost to exports from foreign firms stockpiling UK goods.

Supply, costs and prices

20 Twelve-month CPI inflation had been 2.4% in September, down from 2.7% in August. That was slightly lower than Bank staff had expected immediately prior to the release, but in line with the *August Inflation Report*. The August CPI outturn, in contrast, had been 0.3 percentage points higher than expected in the *August Report*. That upside news had been concentrated in a number of components that tended to be erratic, such as air and sea fares, recreational services, and clothing and footwear, and so the news had been expected to unwind. The September outturn was consistent with that view. Bank staff now expected that CPI inflation would remain around 2½% for the rest of 2018, before falling closer to 2% in January after the introduction of Ofgem's proposed price cap on standard variable tariffs for gas and electricity.

21 Higher growth in domestic costs was expected to push up on CPI inflation over the forecast period. There had been mixed news lately on measures of domestically generated inflation, although most measures had remained below Bank staff's estimates of their target-consistent ranges. The GVA deflator for the services sector and the services producer price index had both picked up. CPI-based measures had been subdued, although CPI services inflation had been affected by some unusual weakness in certain components, including housing rents, some of which was likely to dissipate over the coming year. Unit labour and unit wage costs, which adjust pay growth for changes in productivity, had been materially lower in 2018 Q2 than expected in the *August Report*. Although these were volatile series that were prone to substantial revision, measures of unit cost growth based on AWE, which was less prone to revision, had been roughly stable.

22 There had been sizable upside news on pay growth, which had risen further. Annual whole-economy regular average weekly earnings growth had picked up to 3.1% in August, from 2.9% in July. This was 0.4 percentage points higher than expected at the time of the *August Report*, and the fastest pace of growth in nearly a decade. Within this, private sector regular pay growth had picked up by more than expected, to 3.1%. Public sector regular pay growth had also picked up markedly, to 2.7% from 2.4%, although this had been broadly in line with expectations. Bonuses had remained relatively weak, but tended to have fewer implications for the outlook for pay. The provisional release of the *Annual Survey of Hours and Earnings* for 2018 had appeared broadly consistent with developments in higher-frequency measures of pay.

23 The acceleration of wages had reflected continued tightness in the labour market. The rates of employment, unemployment and participation had all been flat in the three months to August, at 61.0%, 4.0% and 63.6% respectively, all in line with the *August Inflation Report*. There had been more substantial news in average hours, which had risen sharply in the three months to August. The level of total hours worked was consequently somewhat higher than embodied in the *August Report*. Employment surveys, including those from the CBI and the Bank's Agents, had weakened a little, although they had remained consistent with ongoing employment growth.

24 Measures of households' inflation expectations had generally been little changed since the MPC's previous meeting, contrasting with the modest pickup in financial market-based measures.

The immediate policy decision

25 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 the Committee faced had been 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. That outlook depended significantly on the nature of EU withdrawal, in particular: the form of new trading arrangements between the European Union and the United Kingdom; whether the transition to them was abrupt or smooth; and how households, businesses and financial markets responded. The implications for the appropriate path of monetary policy would depend on the balance of the effects on demand, supply and the exchange rate. As set out in more detail in Box 4 in the *November Inflation Report*, the MPC judged that the monetary policy response to Brexit, whatever form it took, would not be automatic and could be in either direction. The Committee noted that greater clarity around Brexit was likely to emerge in the relatively near term.

26 The Committee considered how the economic outlook had changed since its September meeting and the *August Inflation Report*.

27 The global economy had continued to grow at above potential rates, supporting UK net trade. Growth had softened, however, and become more uneven across countries. Global financial conditions had tightened, particularly in emerging market economies, and activity had slowed in the euro area. Trade tensions had remained and global risk sentiment had deteriorated. There was a risk that global financial conditions would tighten further and faster than currently expected by financial markets, posing a downside risk to global activity.

28 Domestically, GDP growth appeared to have been a little stronger than expected in Q3, with all of the main sectors having made positive contributions to growth in the three months to August. Much of this strength was likely to have marked a recovery of weakness earlier in the year, however, and the Committee expected a more modest pace of growth in Q4.

29 There had been further indications that demand was being supported to a greater extent by household consumption and less by business investment than had previously been expected. Official estimates of consumption growth had been revised up for the first half of the year, and it appeared that momentum in household demand had been maintained into H2 by the strong labour market and resilient household confidence. Over the forecast period, consumption was projected to grow modestly relative to historical rates, broadly in line with real incomes. In contrast, business investment had been weaker than previously anticipated, and the recent intensification of Brexit uncertainty appeared likely to keep business spending subdued in the near term. That uncertainty might contribute to some volatility in activity data. Under the smooth transition assumption on which the forecast was conditioned, greater clarity was expected to emerge in the coming months and investment growth was therefore expected to pick up. The MPC's projections had been finalised before the Budget measures had been announced, and the Committee would assess the implications at its next meeting.

30 The Committee judged that aggregate supply and demand were now broadly in balance. The labour market had remained tight, with the employment rate and vacancies around record highs, and the unemployment rate at its lowest since the mid-1970s. Average hours worked were estimated to have increased sharply. Moreover, regular pay growth had been stronger than expected, rising to over 3%.

31 CPI inflation had been 2.4% in September, 0.3 percentage points lower than in August as some erratic factors had unwound. The September outturn had been in line with the expectation at the time of the August *Inflation Report*. Measures of domestically generated inflation had generally been below their estimated target-consistent ranges. However, these measures could be volatile. The Committee continued to judge that underlying domestic inflationary pressure would firm over the forecast period.

32 The Committee's projections were conditioned on the gently rising path of Bank Rate implied by market yields and on a smooth adjustment to the average of a range of possible outcomes for the United Kingdom's eventual trading relationship with the European Union. In the MPC's central projection, GDP was expected to grow by around 1¼% per year on average over the forecast period. Although modest by historical standards, this was slightly faster than the diminished rate of supply growth, which averaged around 1½% per year. With demand and supply currently broadly in balance, a margin of excess demand was expected to build during the forecast period, feeding through into higher growth in domestic costs than had been seen in recent years. At the same time, the contribution of external cost pressures, which had accounted for above-target inflation since the beginning of 2017, was projected to ease. Taking these influences together, CPI inflation was projected to remain above the target for most of the forecast period before reaching 2% by the end of the third year.

33 At this meeting the MPC judged that the current stance of monetary policy remained appropriate. The Committee also judged that, were the economy to continue to develop broadly in line with the November

Inflation Report projections, an ongoing tightening of monetary policy over the forecast period would be appropriate to return inflation sustainably to the 2% target at a conventional horizon, and that any future increases in Bank Rate were likely to be at a gradual pace and to a limited extent.

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

Bank Rate should be maintained at 0.75%;

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.

The Committee voted unanimously in favour of all three propositions.

35 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
Jonathan Haskel
Michael Saunders
Silvana Tenreyro
Gertjan Vlieghe

Vanessa MacDougall 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, Bradley Fried and David Prentis were also present on 25 October, and Bradley Fried was present on 29 October, as observers for the purposes of exercising oversight functions in their roles as members of the Bank's Court of Directors.