



BANK OF ENGLAND

Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 12 September 2018

Publication date: 13 September 2018

These are the minutes of the Monetary Policy Committee meeting ending on 12 September 2018.

They are available at <https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2018/september-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 31 October will be published on 1 November 2018.

Monetary Policy Summary, September 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 12 September 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.

In the MPC's most recent economic projections, set out in the August *Inflation Report*, GDP was expected to grow by around 1¼% per year on average over the forecast period, conditioned on the gently rising path of Bank Rate implied by market yields at that time. Although modest by historical standards, the projected pace of GDP growth was slightly faster than the diminished rate of supply growth, which averaged around 1½% per year. With a very limited degree of slack remaining, a small margin of excess demand was therefore projected to emerge by late 2019 and build thereafter, feeding through into higher growth in domestic costs than has been seen over recent years. The contribution of external cost pressures, which has accounted for above-target inflation since the beginning of 2017, was projected to ease over the forecast period. Taking these influences together, and conditioned on the gently rising path of Bank Rate, CPI inflation remained slightly above 2% through most of the forecast period, reaching the target in the third year.

Recent news in UK macroeconomic data has been limited and the MPC's August projections appear to be broadly on track. UK GDP grew by 0.4% in 2018 Q2 and by 0.6% in the three months to July. The UK labour market has continued to tighten, with the unemployment rate falling to 4.0% and the number of vacancies rising further. Regular pay growth has risen further to around 3% on a year earlier. CPI inflation was 2.5% in July.

The global economy still appears to be growing at above-trend rates, although recent developments are likely to have increased downside risks around global growth to some degree. In emerging market economies, indicators of growth have continued to soften and financial conditions have tightened further, in some cases markedly. Recent announcements of further protectionist measures by the United States and China, if implemented, could have a somewhat more negative impact on global growth than was anticipated at the time of the August *Report*.

The MPC continues to recognise that the economic outlook could be influenced significantly by the response of households, businesses and financial markets to developments related to the process of EU withdrawal. Since the Committee's previous meeting, there have been indications, most prominently in financial markets, of greater uncertainty about future developments in the withdrawal process.

The Committee judges that, were the economy to continue to develop broadly in line with the August *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. As before, these projections were conditioned on the expectation of a smooth adjustment to the average of a range of possible outcomes for the United Kingdom's eventual trading relationship with the European Union. At this meeting, the Committee judged that the current stance of monetary policy remained appropriate. 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 12 September 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 In the period since the Committee's previous meeting, changes in most advanced economies' interest and exchange rates had been relatively small. Against a longer-term backdrop of rising US interest rates and a stronger dollar, geopolitical and economic developments had resulted in a sharp pickup in volatility in emerging markets' financial asset prices and some broader deterioration in risk sentiment.

3 In the United Kingdom, the increase in Bank Rate in August had been widely anticipated by financial market participants, and UK shorter-term interest rates had been little changed since the MPC's previous meeting. US and euro-area short rates were also little changed over the same period.

4 Over the period as a whole, the sterling exchange rate index had been unchanged from the conditioning assumption underpinning the August *Inflation Report*. Sterling had, however, continued to be influenced by developments related to the UK's withdrawal from the European Union. According to the latest Reuters poll of economists, the median probability attached to a disorderly withdrawal was 25%, slightly higher than earlier in the year. Market intelligence had suggested that market participants were insuring against such an outcome to a greater degree. Consistent with that, since the Committee's previous meeting, sterling-dollar implied volatilities had increased, indicating that markets were placing somewhat higher weight on larger future moves in sterling. Sterling-dollar risk reversals had fallen to their lowest levels for over a year, suggesting an increase in perceived downside risks to the exchange rate. And there had been increased activity in interest rate option positions that would benefit from any reduction in Bank Rate in 2019.

5 The US dollar ERI had risen by around 2%, continuing the appreciation that had begun in April. The euro ERI had been broadly unchanged since the Committee's previous meeting.

6 The stronger dollar and increasing US interest rates, together with geopolitical developments including further trade tensions, had been associated with volatility in emerging market currencies and a tightening in financial conditions in those economies over recent months. Since the Committee's previous meeting, financial market volatility had been centred on Turkey and Argentina. The Turkish lira had depreciated by around 25% against the US dollar following an escalation of diplomatic and trade tensions. In Argentina, the peso had depreciated by around 30%, official interest rates had increased by 20 percentage points to 60%, and the government had requested the early disbursement of an IMF support package. A broader range of emerging market currencies had also experienced significant depreciations against the US dollar, including the South African rand, the Brazilian real, and the Russian rouble. Emerging market sovereign bond spreads had increased significantly since the Committee's previous meeting, and equity prices had fallen further.

7 Volatility in emerging markets had contributed to a broader weakening in risk sentiment over recent weeks, which was evident in some advanced economies' asset prices. UK and euro-area equity prices were somewhat lower than at the time of the August MPC meeting, although US equity prices had continued to increase. Corporate bond spreads had generally risen a little in the UK, US and euro area. Since the Committee's previous meeting, Italian government bond spreads to German bunds had been volatile.

The international economy

8 Activity data in advanced economies had evolved broadly in line with the Committee's expectations at the time of the August *Inflation Report*. Indicators of growth in emerging markets had, however, continued to soften and the tightening in financial conditions in these economies was likely to be a drag on growth. World goods trade volumes had been flat on a three month on three month basis in June, according to the CPB series. Trade tensions had escalated as the United States indicated it could implement higher and broader tariffs on Chinese imports than had previously been announced, posing a downside risk to world trade and activity.

9 After strong growth in 2017, euro-area activity had slowed in the first half of this year. GDP growth had been 0.4% in 2018 Q2, 0.1 percentage points higher than in the preliminary estimate. The expenditure breakdown had suggested that net trade had been a drag on growth. Recent purchasing managers' indices had been broadly in line with expectations and Bank staff continued to expect euro-area GDP to grow by around 0.5% in Q3.

10 In the United States, the second estimate of GDP growth in 2018 Q2 had been unrevised at 1.0%. Relative to the advance estimate, upward revisions to business investment, government consumption and stock building had offset downside news on residential investment and private consumption. Early indicators of Q3 activity had been somewhat stronger than expected, and Bank staff expected GDP growth of 0.9%, slightly higher than at the time of the August *Report*. Fiscal loosening measures were expected to support activity over the remainder of 2018 and particularly in 2019. There had nevertheless been tentative signs in some survey data that trade tensions were beginning to have a dampening effect: both the ISM manufacturing new export orders and University of Michigan consumer sentiment surveys had weakened in recent months, with respondents citing concerns over tariffs, although both remained at relatively high levels.

11 In China, high-frequency and survey measures of activity had been mixed, but had continued to suggest quarterly GDP growth of around 1½% in 2018 Q3, down slightly from 1.8% in Q2. There was a risk that trade tensions could weigh more heavily on growth during the second half of the year.

12 In other emerging markets, high-frequency data had pointed to a slowing in activity. Tighter financial conditions had dampened growth this year and were likely to drag further looking ahead. Turkey and Argentina had seen the sharpest deterioration in financial conditions, reflecting a combination of idiosyncratic political and economic factors together with underlying macroeconomic vulnerabilities, including their greater reliance on external capital. The UK's direct trade linkages and banking sector exposures to these countries were limited. Other major emerging market economies had somewhat stronger fundamentals generally and, since the MPC's previous meeting, there had been little evidence of material investment fund outflows from emerging market

economies as a whole. Previous crises had highlighted the risk of contagion, however, including if investors sought to reduce their exposures by withdrawing funds more rapidly.

13 The Brent oil futures curve had increased by around 5% in dollar terms relative to its level at the time of the *August Report*, while non-oil commodity prices had fallen by 3%. In the euro area, the August flash estimate had indicated that annual HICP inflation fell back slightly to 2.0%, while core inflation remained subdued. In the United States, both headline and core PCE inflation had picked up slightly in July, taking the former to its highest level since March 2012. Annual average hourly earnings growth in the United States had picked up to 2.9% in August, its highest level since 2009, and somewhat above market expectations.

Money, credit, demand and output

14 According to the first quarterly estimate, GDP had grown by 0.4% in 2018 Q2, in line with expectations at the time of the *August Inflation Report*. The GDP release had also contained the first estimate of the Q2 expenditure components, although the ONS's new publication schedule for GDP data meant that a slightly smaller proportion of measured expenditure data was available than had been the case previously. The contribution to growth of net trade had been surprisingly weak in the initial release. There had, however, been a tendency in recent years for initial estimates of net trade to be revised up significantly. Revisions in the July trade release had already suggested that the net trade contribution in Q2 would be revised up.

15 The Committee considered the outlook for activity over the remainder of this year. Taken together, business surveys had remained consistent with steady growth. GDP had risen by 0.6% in the three months to July, marginally stronger than expected, and staff had revised up their nowcast for Q3 growth to 0.5% from the 0.4% expected at the time of the *August Report*. Services output had risen by 0.6% in the three months to July and construction output had grown very strongly. It appeared likely that growth in manufacturing would rebound in Q3 after erratic weakness in Q2, although output in this sector had fallen slightly on the month in July.

16 Most indicators of exports and investment intentions had held up in recent months, although there had been a sharp fall in the IHS Markit/CIPS goods export orders index in August. Some respondents to that survey, and the associated equivalents for the service and construction sectors, had noted uncertainty around the UK's withdrawal from the European Union. And reports from the Bank's Agents had also suggested that companies were becoming more uncertain about the economic outlook and were considering their Brexit contingency plans more carefully. Only a small minority of companies had started to implement plans such as increasing stocks of components imported from the European Union or reassessing their transport and logistics arrangements. It would be important to monitor closely such developments, and their possible impact on broader economic indicators, over coming months.

17 Recent news concerning household consumption had been mixed. Growth in retail sales volumes had remained strong in the three months to July. Consumer confidence had fallen back slightly in August, according to GfK/European Commission data, after rising significantly in July. Private car registrations had risen very sharply in August, although that appeared to have reflected the pre-registration of existing stock by dealers ahead of the introduction of the Worldwide Harmonised Light Vehicle Test Procedure and so was likely to unwind in coming months. Indicators of house prices were generally pointing to slight upside risks around the

near-term projections in the *August Report*. The flow of consumer credit had been notably weak in July, however, reflecting both higher repayments and weaker gross lending. On balance, spending in the third quarter might prove to be slightly stronger than expected. Given the various erratic factors that had affected spending in recent quarters, however, the Committee did not at this stage draw a strong signal as to whether the outlook for consumption had changed materially.

18 Although it was too early to arrive at a comprehensive view of the effects of last month's increase in Bank Rate, the initial impact on interest rates faced by households and companies had been consistent with the pass-through of the November 2017 Bank Rate increase. Variable mortgage rates had adjusted fully to August's 0.25 percentage point increase and the pricing of fixed-rate mortgages had generally increased prior to the rise in Bank Rate, reflecting the move up in swap rates earlier this year as financial markets had anticipated a tightening in monetary policy. Household sight deposit rates were likely to increase in coming months, although the Committee's expectation was that pass-through would be only partial, as deposit rates had been unusually high relative to Bank Rate during the post-crisis period.

Supply, costs and prices

19 In July, twelve-month CPI inflation had risen slightly to 2.5%. That was 0.1 percentage points lower than projected in the *August Inflation Report*, however, continuing a series of small downside errors since the beginning of 2018. Although some of the forecast error in July had been accounted for by lower than expected clothing and footwear prices, which were judged to reflect erratic seasonal discounting, other parts of the downside news were expected to persist over coming months.

20 The path of CPI inflation over the next few months would be influenced by recent developments in energy markets. Sterling oil prices had risen by 8% since the *August Report*, and that would raise fuel prices. In addition, some gas and electricity prices would rise in the near term, as a number of utilities companies had announced increases, and the level of the safeguard tariff set by Ofgem would rise in October due to higher wholesale gas and electricity costs over the past few quarters. Acting in the opposite direction, Ofgem had proposed a price cap on standard variable tariffs for retail energy. If implemented, the cap would reduce inflation over the course of 2019, probably to a somewhat greater extent than had been incorporated into the MPC's August forecast.

21 CPI-based measures of domestically generated inflation had remained subdued, but were projected to rise somewhat over coming months. That would be consistent with the recent sustained growth in labour costs, which were the largest domestic cost facing most companies. Prospects for inflation would depend on how pay developed relative to productivity. The MPC's August projections assumed that both factors would pick up over the forecast period, and that unit labour cost growth would be sustained at higher levels than in previous years.

22 The labour market had remained tight and pay growth had risen. Surveys had indicated that recruitment difficulties were widespread across the economy. The unemployment rate had fallen to 4.0% in the three months to July, in line with the *August Report* forecast. Job-to-job flows had picked up in Q2 after falling slightly in Q1, leaving them close to their pre-crisis average and well above levels seen in recent years. Claimant count data, adjusted for the effects of Universal Credit, had pointed to a further decline in unemployment in the near

term. Consistent with that, the vacancy rate had risen again and expectations of hiring from surveys had continued to point to solid labour demand.

23 Annual growth in whole economy average weekly earnings, excluding the volatile bonus component, had been 2.9% in the three months to July. That was a little stronger than had been expected in the *August Report*. In the private sector, earnings excluding bonuses had grown by 3.0% in the three months to July, which was also slightly higher than expected. The growth rates of measures that included bonuses, which tended to be more volatile, had been somewhat lower, at just over 2½%. According to the Bank's settlements database, the distribution of private sector pay settlements so far in 2018 had continued to shift up relative to 2017. The REC pay indices had remained well above their historical averages, and the Agents' scores for growth in labour costs had strengthened in recent months.

24 While the number of people in work had risen over the past year, average hours worked had fallen, and recent outturns had been slightly weaker than expected at the time of the *August Report*. LFS microdata had suggested that the decline in average hours worked over the past few quarters reflected people taking more holiday leave than had been the case over recent years, as well as some temporary effects from adverse weather earlier this year.

25 Given the differing evolution of employment and average hours over recent quarters, productivity measures had diverged. Annual growth in output per hour had picked up to around 1½% in 2018 Q2. In contrast, annual growth in output per head – which was the relevant comparator to average weekly earnings growth – had remained low, at around ¼%. On both measures, however, productivity growth had remained subdued relative to pre-crisis averages.

The immediate policy decision

26 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. 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, there had been indications, most prominently in financial markets, of greater uncertainty about future developments in the withdrawal process.

27 In the MPC's most recent economic projections, set out in the *August Inflation Report*, GDP had been expected to grow by around 1¼% per year on average over the forecast period, conditioned on the gently rising path of Bank Rate implied by market yields at that time. Although modest by historical standards, the projected pace of GDP growth was slightly faster than the diminished rate of supply growth, which had averaged around 1½% per year. With a very limited degree of slack remaining, a small margin of excess demand had therefore been projected to emerge by late 2019 and build thereafter, feeding through into higher growth in domestic costs than had been seen over recent years. The contribution of external cost pressures, which had accounted for above-target inflation since the beginning of 2017, had been projected to ease over the forecast period.

Taking these influences together, and conditioned on the gently rising path of Bank Rate, CPI inflation had remained slightly above 2% through most of the forecast period, reaching the target in the third year.

28 The Committee reviewed the extent to which recent developments were consistent with the projections in the *August Report*.

29 Against a longer-term backdrop of rising US interest rates and a stronger dollar, geopolitical and economic developments had resulted in a sharp pickup in volatility in emerging markets' financial asset prices and some broader deterioration in risk sentiment. Tighter financial conditions had dampened growth in emerging markets this year and were likely to drag further looking ahead. The UK's direct trade linkages and banking sector exposures to Turkey and Argentina were limited, and other major emerging market economies had somewhat stronger fundamentals. Nevertheless, previous crises had highlighted the risk of contagion.

30 Early indicators of Q3 activity in the United States had been somewhat stronger than expected, and Bank staff expected slightly higher GDP growth than at the time of the *August Report*. Near-term growth in the euro area appeared to be broadly on track to meet the August projection. Nevertheless, recent announcements of further protectionist measures by the United States and China, if implemented, could have a somewhat more negative impact on global growth than had been anticipated at the time of the *August Report*.

31 UK GDP had grown by 0.4% in 2018 Q2, in line with the Committee's expectations. Business surveys released since the MPC's previous meeting had remained consistent with steady growth. GDP had risen by 0.6% in the three months to July, marginally stronger than expected, and staff had revised up their nowcast for Q3 growth to 0.5% from the 0.4% expected at the time of the *August Report*.

32 Although the Committee placed relatively little weight on the first estimate of the Q2 expenditure components, other indicators had suggested that the rotation in demand, away from household consumption and towards net trade and business investment, might be somewhat less marked than had been previously assumed. The outlook for household consumption had not changed materially, but if anything spending in the third quarter might prove to be slightly stronger than expected. Although most indicators of exports and investment intentions had held up in recent months, there had been a sharp fall in the goods export orders PMI in August. Evidence from PMI surveys and the Bank's Agents had also suggested that companies were becoming more uncertain about the economic outlook.

33 The UK labour market had continued to tighten, with the unemployment rate falling to 4.0% in the three months to July. Claimant count data had pointed to a further decline in unemployment in the near term and surveys of employment expectations had continued to point to solid labour demand. Annual earnings growth including bonuses had been just over 2½%. Less volatile regular pay measures had grown by around 3% on a year earlier, a little stronger than had been expected in the *August Report*. Evidence from pay settlements and surveys was consistent with some further rise in earnings growth.

34 CPI inflation had been 2.5% in July, marginally lower than expected, and continuing a series of small downside errors since the beginning of this year. The path of CPI inflation over coming months would be influenced by a range of recent developments in energy markets, acting in different directions. Ofgem's price

cap proposal for standard variable tariffs was likely to reduce inflation to a somewhat greater extent over the course of 2019 than had been incorporated into the MPC's August forecast.

35 The initial impact on interest rates faced by households and companies from last month's increase in Bank Rate had been consistent with the pass-through of the November 2017 rate increase, although it was too early to arrive at a comprehensive view of its effects.

36 The Committee turned to the immediate policy decision.

37 The MPC's August projections appeared to be broadly on track. UK GDP had grown by 0.4% in 2018 Q2 and by 0.6% in the three months to July. The UK labour market had continued to tighten, with the unemployment rate falling to 4.0% and the number of vacancies rising further. Regular pay growth had risen further to around 3% on a year earlier. CPI inflation had been 2.5% in July. Although the global economy still appeared to be growing at above-trend rates, recent developments in emerging markets and the ongoing escalation of trade tensions were likely to have increased downside risks around global growth to some degree.

38 The Committee judged that, were the economy to continue to develop broadly in line with the August *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. As before, these projections had been conditioned on the expectation of a smooth adjustment to the average of a range of possible outcomes for the United Kingdom's eventual trading relationship with the European Union. Any future increases in Bank Rate were likely to be at a gradual pace and to a limited extent.

39 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 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.

The Committee voted unanimously in favour of all three propositions.

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
Jonathan Haskel
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, Bradley Fried was also present on 6 and 7 September, Dorothy Thompson was present on 6 September, and Anne Glover was present on 7 September, as observers for the purposes of exercising oversight functions in their roles as members of the Bank's Court of Directors.