BANK OF ENGLAND

Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 15 December 2021

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These are the minutes of the Monetary Policy Committee meeting ending on 15 December 2021.

They are available at https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2021/december-2021.

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 2 February will be published on 3 February 2022.

Monetary Policy Summary, December 2021

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 15 December 2021, the MPC voted by a majority of 8-1 to increase Bank Rate by 0.15 percentage points, to 0.25%. The Committee voted unanimously for the Bank of England to maintain the stock of sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, at £20 billion. The Committee also voted unanimously to maintain the stock of UK government bond purchases, financed by the issuance of central bank reserves, at £875 billion, and so the total target stock of asset purchases at £895 billion.

In the MPC's central projections in the November *Monetary Policy Report*, global and UK GDP were expected to recover further from the effects of Covid-19 (Covid) in the near term. Conditioned on the rising path for Bank Rate expected by financial markets at that time, upward pressure on CPI inflation was expected to dissipate over time, as supply disruption eased, global demand rebalanced from goods to services, and energy prices stopped rising. Earnings growth was also expected to fall back from its current rate. As a result, inflation was projected to fall back materially from the second half of next year.

Since the November MPC meeting, the Omicron Covid variant has emerged. It appears to be spreading rapidly within the United Kingdom and around the world. The new variant appears to be much more transmissible than the Delta variant and, on the basis of current knowledge, poses new risks to public health. Global risky asset prices fell in response to this news but have since largely recovered. Longer-term advanced-economy government bond yields have declined.

The level of global GDP in 2021 Q4 is likely to be broadly in line with the November *Report* projection, but consumer price inflation in advanced economies has risen by more than expected. The Omicron variant poses downside risks to activity in early 2022, although the balance of its effects on demand and supply, and hence on medium-term global inflationary pressures, is unclear. Global cost pressures have remained strong.

Bank staff have revised down their expectations for the level of UK GDP in 2021 Q4 by around ½% since the November *Report*, leaving GDP around 1½% below its pre-Covid level. Growth in many sectors has continued to be restrained by disruption in supply chains and shortages of labour. The impact of the Omicron variant, associated additional measures introduced by the UK Government and Devolved Administrations, and voluntary social distancing will push down on GDP in December and in 2022 Q1. The experience since March 2020 suggests that successive waves of Covid appear to have had less impact on GDP, although there is uncertainty around the extent to which that will prove to be the case on this occasion.

The Labour Force Survey unemployment rate fell to 4.2% in the three months to October, while the number of payrolled employees continued to rise strongly in November. There is little sign in the available data that the closure of the Coronavirus Job Retention Scheme at the end of September has led to a weakening in the labour market. The LFS unemployment rate is now expected to fall to around 4% in 2021 Q4, compared with the 4½% projection in the November *Report*. Bank staff continue to estimate that underlying earnings growth has remained above pre-pandemic rates, and the Committee continues to see upside risks around the projection for pay in the November *Report*.

Twelve-month CPI inflation rose from 3.1% in September to 5.1% in November, triggering the exchange of open letters between the Governor and the Chancellor of the Exchequer that is being published alongside this monetary policy announcement. Relative to the November *Report* projection, there has been significant upside news in core goods and, to a lesser extent, services price inflation. Bank staff expect inflation to remain around 5% through the majority of the winter period, and to peak at around 6% in April 2022, with that further increase accounted for predominantly by the lagged impact on utility bills of developments in wholesale gas prices. Indicators of cost and price pressures have remained at historically elevated levels recently, and contacts of the Bank's Agents expect further price increases next year driven in large part by pay and energy costs. CPI inflation is still expected to fall back in the second half of next year.

The MPC's remit is clear that the inflation target applies at all times, reflecting the primacy of price stability in the UK monetary policy framework. The framework also recognises that there will be occasions when inflation will depart from the target as a result of shocks and disturbances. In the recent unprecedented circumstances, the economy has been subject to very large and repeated shocks. Given the lag between changes in monetary policy and their effects on inflation, the Committee, in judging the appropriate policy stance, will as always focus on the medium-term prospects for inflation, including medium-term inflation expectations, rather than factors that are likely to be transient.

At its November meeting, the Committee judged that, provided the incoming data, particularly on the labour market, were broadly in line with the central projections in the November *Monetary Policy Report*, it would be necessary over coming months to increase Bank Rate in order to return CPI inflation sustainably to the 2% target. Recent economic developments suggest that these conditions have been met. The labour market is tight and has continued to tighten, and there are some signs of greater persistence in domestic cost and price pressures. Although the Omicron variant is likely to weigh on near-term activity, its impact on medium-term inflationary pressures is unclear at this stage.

The Committee judges that an increase in Bank Rate of 0.15 percentage points is warranted at this meeting.

The MPC will review developments, including emerging evidence on the implications for the economy of the Omicron variant, as part of its forthcoming forecast round ahead of the February 2022 *Monetary Policy Report*. The Committee will, as always, continue to focus on the medium-term prospects for inflation. The Committee continues to judge that there are two-sided risks around the inflation outlook in the medium term, but that some modest tightening of monetary policy over the forecast period is likely to be necessary to meet the 2% inflation target sustainably. The Committee will reach its assessment on the balance of the risks to medium-term inflation in light of the relevant data as they emerge.

Minutes of the Monetary Policy Committee meeting ending on 15 December 2021

1 Before turning to its immediate policy decision, the Committee discussed: the international economy; monetary and financial conditions; demand and output; and supply, costs and prices.

The international economy

2 UK-weighted world GDP was expected to grow by 0.8% in 2021 Q4, broadly in line with the projection in the November *Monetary Policy Report*. Supply disruptions, and an increase in Covid-19 (Covid) cases with associated measures, were expected to weigh on euro-area activity, while the US economy was expected to grow more strongly than had been anticipated. Compared to pre-Covid levels, demand for goods had continued to be strong relative to services in the United States, with US households driving almost the entire increase in durable goods consumption across G7 economies over that period. The emergence and spread of the Omicron Covid variant posed downside risks to the global recovery in activity, with the overall effect on inflation unclear.

3 In the euro area, GDP had risen by 2.2% in 2021 Q3 according to the third release, a little stronger than incorporated into the November *Report*, and leaving the level of GDP only 0.3% below that in 2019 Q4. Bank staff expected GDP to grow by 0.5% in the fourth quarter, slower than had been anticipated in the November *Report*. Even prior to the emergence of the Omicron variant, Covid cases had risen sharply across the region, and several countries had tightened measures during November and December. The composite output PMI had increased to 55.4 in November, driven by a pickup in services output, but mobility indicators had fallen back recently. Supply bottlenecks had also weighed on production, although the manufacturing output PMI had remained in expansionary territory. The euro-area unemployment rate had decreased slightly in October, to 7.3%, and euro-area wage growth had remained moderate in 2021 Q3.

4 In the United States, GDP had increased by 0.5% in 2021 Q3 according to the second estimate, weaker than had been expected in the November *Report*. This had left the level of GDP 1.4% higher than in 2019 Q4. In the fourth quarter, US GDP was expected to expand by 1.4%, higher than anticipated in the November *Report*. Household spending had grown strongly in October, although the expected rotation of demand towards services had stalled. Strength in goods spending had continued, particularly durables expenditure, which had increased again after declining earlier in the year as fiscal support had faded. In the labour market, non-farm payrolls had grown by only 210,000 in November, but the unemployment rate had fallen to 4.2%. Wage growth had picked up across a number of indicators, but had remained broadly in line with pre-Covid rates after adjusting for compositional and demographic effects.

5 In China, localised Covid outbreaks and associated measures had weighed on activity. GDP was expected to grow by 1.0% in 2021 Q4, a little below the estimate in the November *Report*. The housing market had continued to weaken. In other emerging markets, activity had generally picked up in 2021 Q3, although there had been differences across countries.

6 Global cost pressures had remained strong and inflation had risen by more in advanced economies than had been expected in the November *Report*. In November, euro-area annual HICP inflation had increased to 4.9%. US CPI inflation had reached 6.8%, consistent with PCE inflation of around 5½% in November. Strong demand for certain goods, supply disruptions and high energy prices had been behind these increases.

7 The MPC discussed the outlook for global inflation. Price pressures in the United States had broadened across sectors, and prices had not fallen back to the extent anticipated in the sectors that had previously experienced the largest increases. There had been mixed signals from early indicators of cost pressures. Wholesale gas spot prices had risen again in Europe and one-year futures prices had reached new highs. Oil and coal prices had declined from their peak, with the Brent oil spot price now around $73 per barrel. Shipping costs had remained elevated, but Chinese PMI manufacturing input prices had eased in the latest data. Indices of prices and delivery times in the United States and in the euro area had still indicated strong pressures, however, and US and euro-area companies had reported higher levels of material shortages. China's zero-Covid strategy alongside the emergence of Omicron could also lead to renewed supply disruptions going forward if, for example, ports and factories were to close.

Monetary and financial conditions

8 In response to news of the emergence and spread of the Omicron variant, global risky asset prices had fallen somewhat, but had since largely recovered. Global equity prices had declined by around 3 to 5% in the days following the initial news, with larger declines in sectors that had been most affected by previous Covid measures. Global corporate bond spreads had also widened, albeit from low levels. Implied volatilities had risen across asset classes. Overall, these moves had been relatively modest, however, and had unwound subsequently in some cases.

9 Longer-term advanced-economy government bond yields had also fallen in response to news of the Omicron variant. In the United States, some of that fall had unwound subsequently, leaving ten-year US government bond yields around 10 basis points lower overall since the MPC's November meeting. In contrast, in the United Kingdom and the euro area, ten-year government bond yields had fallen by around 20 to 30 basis points since the Committee's previous meeting. Those falls had largely been accounted for by a reduction in the real component of nominal interest rates.

10 The path for market-implied policy rates in the United States had risen somewhat since the MPC's previous meeting. In part, that was likely to have reflected US CPI data and Federal Open Market Committee (FOMC) communications. At its 3 November meeting, the FOMC had left its target range for the federal funds rate unchanged and had begun to reduce the monthly pace of its asset purchases. The minutes of that FOMC meeting had noted that some participants preferred a somewhat faster pace of reductions that would result in an earlier conclusion to net purchases, an option which Chair Powell had noted subsequently he expected would be discussed again at the FOMC's forthcoming meeting on 15 December. The market-implied policy rate in the United States now reached around 0.7% by end-2022 and 1.3% by end-2023, around 10 basis points higher

than immediately prior to the MPC's November meeting. In contrast, the market-implied path for policy rates in the euro area had moved down a little over the same period.

11 In the United Kingdom, market-implied expectations for the path of Bank Rate had fallen sharply immediately following the MPC's November meeting. Market contacts were expecting Bank Rate to rise in the coming months. In the days running up to the MPC's December meeting, most contacts had expected Bank Rate to remain at 0.1% at this meeting. Following the UK CPI release on 15 December, however, market pricing had become more finely balanced between Bank Rate remaining at 0.1% and an increase of 15 basis points at this meeting. Further out, the market-implied path for Bank Rate reached 1.1% by the end of 2022. Volatility in UK short-term interest rate markets had remained elevated since the Committee's previous meeting, in part reflecting diminished market liquidity, some of which was expected to persist over the year-end period.

12 Medium-term inflation compensation measures in the United Kingdom had remained above their average levels of the past decade. That contrasted with similar measures in the United States and the euro area which had been around their average levels of the past decade.

13 As the Committee had discussed at its previous meeting, interpreting UK medium-term inflation compensation measures was not straightforward. The use of UK inflation markets for hedging large pension liabilities and the uncertain future wedge between consumer price and RPI inflation meant that inflation compensation measures did not provide a direct read of market participants' fundamental views on the inflation outlook. Nevertheless, models that attempted to extract medium-term market expectations for CPI inflation, and intelligence gathered from market contacts, suggested that higher inflation expectations and greater perceived risks to inflation might have in part accounted for the above-average levels of medium-term inflation compensation measures, alongside other factors.

14 The sterling effective exchange rate index had fallen by around 1% since the MPC's previous meeting, with a somewhat sharper depreciation of sterling against the dollar of around 3%.

15 Moves in lending rates on UK mortgages had been mixed since the Committee's previous meeting. Interest rates on mortgages with loan-to-value (LTV) ratios at or below 75% had risen by around 30 basis points from their recent low points. This was consistent with a lagged response to the increases in risk-free rates since the autumn, with around half of those increases now having passed through to lending rates. Higher LTV mortgage rates had continued to fall since the Committee's previous meeting, albeit at a slower pace. There had been a normalisation in housing activity measures following the end of the stamp duty holiday, while indicators of house price inflation had remained robust.

16 At its December 2021 meeting, the Bank's Financial Policy Committee (FPC) had announced an increase in the UK countercyclical capital buffer rate from 0% to 1%, coming into effect from 13 December 2022 in line with the usual twelve-month implementation period. It would also expect to increase the rate further to 2% in 2022 Q2, if the UK economic recovery proceeded broadly in line with the MPC's central projections in the November *Monetary Policy Report*, and absent a material change in the outlook for UK financial stability. The FPC had also reviewed its mortgage market Recommendations, including considering how its measures had operated since they had been put in place. The FPC's analysis had suggested that its loan to income (LTI) flow

limit played a stronger role than its affordability test in guarding against an increase in aggregate household indebtedness and the number of highly indebted households when house prices rose rapidly. The FPC had therefore decided to maintain the LTI flow limit Recommendation, but to consult, in the first half of 2022, on withdrawing its affordability test.

Demand and output

17 According to the ONS's first quarterly estimate, UK GDP had risen by 1.3% in 2021 Q3, a little weaker than the 1.5% projection that had been incorporated into the November *Monetary Policy Report*. That had left the level of Q3 GDP 2.1% below its pre-Covid level in 2019 Q4. Within that, the initial estimates of private consumption and investment growth, which were often subject to revision, had been materially lower than expected. Total government expenditure had risen by 1.3%, higher than had been expected in the November *Report*. The sum of the Q3 expenditure components had been significantly less than headline GDP, indicating uncertainty surrounding the expenditure estimates and the possibility of an upward revision to spending in forthcoming releases.

18 GDP growth in October had been a little weaker than expected, at 0.1%. In both September and October, growth had been driven in part by increases in health spending, reflecting strong non-Covid activity such as doctor appointments. There had also been growth in transport and work-related activities, which had reflected the return of workers to offices and higher mobility in general. By contrast, output in some business-to-business services, such as information and communications, and finance, had weakened. Construction output had fallen in October, although this had followed a sharp rise in September.

19 Supply chain disruptions had remained acute, but did not appear to have weighed on activity by more than had been anticipated in the November *Report*. This was consistent with there having been little news to the level of output in those sectors that had previously been most affected by disruptions, such as manufacturing and construction. The global semiconductor shortage had continued to weigh on car production in particular, and there had been evidence that low availability had constrained new car purchases. According to the latest IHS Markit/CIPS manufacturing PMI surveys, supplier delivery times had continued to lengthen in November, and backlogs of work had continued to rise. Other indicators had also shown no easing in supply chain disruptions. The proportion of firms reporting non-labour input disruptions and significant recruitment difficulties in the November Decision Maker Panel had increased slightly, and the Bank's Agents had reported an increase in the number of contacts reporting constraints to growth, primarily due to labour shortages but also demand for goods becoming harder to fulfil due to supply chain disruptions. An increasing number of Agents' contacts had also reported that they expected supply issues to persist until the second half of 2022, and possibly 2023 or 2024 in some cases.

20 Retail sales volumes had increased in October, leaving the level of sales around 5½% above its pre-Covid level. Some indicators of card spending suggested retail spending had remained robust in November. The Bank's Agents had reported companies' concerns about being able to meet demand for Christmas, and that a lack of stock availability was reducing consumer choice. Looking ahead, the emergence and spread of the

Omicron variant was likely to encourage goods, relative to services, spending, as the goods-to-income ratio had returned to around its pre-Covid level.

21 The number of Covid cases had picked up in the days leading up to the MPC's December meeting. With the identification of the Omicron variant, measures had been put in place in England at the end of November and during the first few days of December. On 8 December, the UK Government had announced that additional measures would be introduced for England, including: guidance on working from home wherever possible; extending the legal requirement to wear a face covering to further public venues; daily testing for contacts of Omicron cases; and the introduction of Covid passes for nightclubs as well as events with large crowds. In the devolved nations, a number of measures were already in place, such as wearing face coverings in public places, advice to work from home and Covid passes. On 12 December, the UK Coronavirus alert level had been raised to level four, as transmission of the new variant was judged to be high or rising exponentially, and the UK Government had announced a plan for all those eligible in England to be offered a booster vaccine by the end of this year, while offering additional support to Devolved Administrations to accelerate their vaccination programmes. On 14 December, the UK Government had announced that it would remove the countries on the UK's travel red list and, in Scotland, people had been advised to limit socialising to three households and physical distancing measures in shops and hospitality venues had been re-introduced.

22 There had been some tentative signs that economic activity had started to be affected by the emergence and spread of Omicron in late November. The number of OpenTable seated diners had fallen in recent weeks, although some of this had probably reflected the impact of storm Arwen at the end of November. UK retail footfall and passenger flight numbers had been flat on the weeks to 4 and 5 December respectively. However, mobility data had suggested a moderate decline in public transport use in early December.

23 Overall, Bank staff had revised down their expectations for 2021 Q4 GDP growth to 0.6%, from 1% at the time of the November *Report*. News to the level of GDP up to October, and the impact from Omicron and associated measures in December, meant that Bank staff now expected GDP in Q4 to be around 1½% below its 2019 Q4 level.

Supply, costs and prices

24 The Labour Force Survey unemployment rate had fallen to 4.2% in the three months to October, 0.2 percentage points below expectations at the time of the November *Monetary Policy Report*. Within that, the number of people who had been unemployed for up to six months had remained around its recent record low, although the number of people unemployed for over twelve months had remained higher than prior to the pandemic. LFS employment had increased by 0.5% in the three months to October, to 1.3% below its 2019 Q4 level, slightly weaker than expected in the November *Report*. Her Majesty's Revenue and Customs (HMRC) employee payrolls had risen strongly by 257,000 in the single month of November, although these initial estimates had tended to be revised down somewhat. Payrolls growth had been revised down in October, for example, from 160,000 to 74,000. Overall, there was little sign in the available official data that the closure of the Coronavirus Job Retention Scheme (CJRS) at the end of September had led to a weakening in the labour

market. Average hours worked had continued to increase in the three months to October, as those on furlough had returned to work, and were now only just over 1% below their 2019 Q4 level. The LFS inactivity rate had been unchanged in the three months to October, and was still around ¾ percentage points higher than immediately prior to the pandemic.

25 General government employment, based on returns from public sector organisations, had increased by around 219,000 in 2021 Q3 compared with its 2019 Q4 level. LFS flows data suggested that recent increases in public sector employment could be almost entirely accounted for by moves from private sector employment.

26 The stock of job vacancies recorded by the ONS had reached 1.2 million in the three months to November, and the ratio of vacancies to unemployment had also reached another record high since a consistent series had been available from 2001. Those increases appeared to reflect strong demand for labour, as labour market flows data up to 2021 Q3 had shown a similarly strong pace of new hiring. The implied average duration of vacancies and Bank staff estimates of labour market matching efficiency had been around pre-Covid levels.

27 More timely indicators of labour market activity had generally remained robust. The IHS Markit/CIPS composite employment PMI had fallen slightly in November, but had remained at a historically elevated level. The REC permanent staff placements and staff availability indices had remained close to recent record high and low levels respectively in November. Contacts of the Bank’s Agents in a range of sectors had reported wanting to take on more staff to meet increased demand, and staff turnover had remained higher than normal for many companies. Recruitment difficulties had also been reported to have become more widespread and acute, particularly for the hiring of experienced staff. Early indications following the emergence and spread of Omicron in the United Kingdom suggested that Adzuna vacancies had fallen back somewhat in the hospitality and catering sector.

28 Overall, Bank staff now expected the LFS unemployment rate to fall to around 4% in 2021 Q4, compared with the 4½% projection in the November *Report*. Abstracting from the risks from the impact of Omicron, it was possible that the unemployment rate could fall further over coming months if hiring continued to keep pace with the current elevated levels of vacancies. Any weakness in demand related to the new variant could offset those forces to some extent.

29 Private-sector regular Average Weekly Earnings (AWE) had risen by 4.7% in the three months to October on a year earlier, weaker than earlier in the year but broadly in line with expectations at the time of the November *Report*. Adjusted for the mechanical effects of the CJRS and changes in composition, Bank staff estimated that private sector regular pay growth had remained at around 4½%, above pre-pandemic rates of around 3%.

30 Other pay indicators had remained strong, consistent with a continuation of the current pace of underlying earnings growth in the near term. The REC permanent staff salaries index, which measured the monthly pay growth of new permanent hires, had increased to another record high in November. Job-to-job flows had reached a record high in 2021 Q3, with particular strength in the number of voluntary resignations. Median pay growth based on HMRC payrolls data had fallen back somewhat from its peak in mid-2021. Looking ahead, a

number of contacts of the Bank's Agents expected further upward pressure on pay growth next year, in part as strength in consumer price inflation could encourage workers to demand higher pay settlements. Overall, should the labour market remain tight, there appeared to be upside risks around the projections in the November *Report* for earnings growth to fall back significantly over the coming year.

31 Twelve-month CPI inflation had risen from 3.1% in September to 5.1% in November, compared with the 4.5% figure expected in the November *Report*. This release had triggered the exchange of open letters between the Governor and the Chancellor of the Exchequer that was being published alongside this monetary policy announcement. Core inflation had also risen to 4.0% in November. Relative to the November *Report* projection, there had been significant upside news in core goods and, to a lesser extent, services price inflation.

32 CPI inflation was expected to remain around 5% through the majority of the winter period, and peak at around 6% in April 2022. The latter would be around one percentage point higher than had been expected in the November *Report*.

33 The further rise in inflation next spring would in large part reflect current developments in wholesale gas and electricity futures prices, which would feed into Ofgem's retail price caps from April. Movements in wholesale prices over much of the period following the November *Report* had been broadly consistent with Bank staff's baseline assumptions of how much these caps were likely to increase, but gas and electricity futures prices had picked up sharply in the days leading up to the MPC's meeting which implied additional upside pressure on utility price inflation if this persisted. The fall in oil prices since the MPC's previous meeting would have a small, and only partly offsetting, negative effect on energy price inflation over coming months.

34 Core goods price inflation was expected to remain well above its pre-Covid average in the near term, accounting for the majority of the remainder of the projected above-target inflation. Services price inflation was projected to remain at above pre-Covid rates and increase somewhat further. Food price inflation was also expected to rise further, reflecting cost increases over recent months.

35 Other indicators of cost and price pressures had remained at historically elevated levels recently. Both the composite input and output price PMIs had reached new record highs in November. A short-term model constructed by Bank staff of CPI inflation excluding energy, housing, education and financial services, based on such survey indicators of price pressures, suggested some additional upside risks around the updated central projection for inflation over the next six months. The Bank's Agents had reported that rising costs were increasingly and more frequently being passed through to prices, and that contacts expected further price increases next year driven in large part by pay and energy costs. CPI inflation was still expected to fall back in the second half of next year.

36 Since the MPC's previous meeting, households' one-year ahead inflation expectations had risen in the 2021 Q4 Bank/Kantar survey, but had remained unchanged in the December Citi/YouGov survey albeit at a higher level. Medium to longer-term household expectations in these surveys had picked up over recent quarters. The Citi/YouGov five to ten-year ahead measure had remained above its historical average, while the Bank/Kantar five-year ahead measure was still slightly below its historical average albeit that there was a break in this series in early 2020 due to the shift from face-to-face to online surveys. The mean response to questions

on three-year and four-year ahead inflation in the HM Treasury survey of professional forecasters had increased significantly recently, but the median response was still consistent with the MPC meeting its 2% inflation target.

The immediate policy decision

37 The MPC sets monetary policy to meet the 2% inflation target, and in a way that helps to sustain growth and employment.

38 In the MPC's central projections in the November *Monetary Policy Report*, global and UK GDP had been expected to recover further from the effects of Covid in the near term. UK consumption growth had been expected to slow over the forecast period, in part reflecting the drag on real incomes from higher energy prices. Conditioned on the rising path for Bank Rate expected by financial markets at that time, upward pressure on UK CPI inflation had been expected to dissipate over time, as supply disruption eased, global demand rebalanced from goods to services, and energy prices stopped rising. Earnings growth had also been expected to fall back from its current rate. As a result, inflation had been projected to fall back materially from the second half of next year. Conditioned on the rising market path for Bank Rate at that time, CPI inflation had been projected to be a little above the 2% target in two years' time and just below the target at the end of the forecast period.

39 Since the November MPC meeting, the Omicron Covid variant had emerged. It appeared to be spreading rapidly within the United Kingdom and around the world. The new variant appeared to be much more transmissible than the Delta variant and, on the basis of current knowledge, posed new risks to public health.

40 The Committee reviewed recent economic developments, most of which pre-dated any possible impact from the emergence and spread of the Omicron variant.

41 The level of global GDP in 2021 Q4 was likely to be broadly in line with the November *Report* projection, but consumer price inflation in advanced economies had risen by more than expected. The Omicron variant posed downside risks to activity in early 2022, although the balance of its effects on demand and supply, and hence on medium-term global inflationary pressures, was unclear. Global cost pressures had remained strong. Notwithstanding an apparent stabilisation in shipping prices, global supply chains had remained heavily disrupted. Companies had reported higher levels of material shortages in the United States and in the euro area.

42 Global risky asset prices had fallen in response to the emergence of the Omicron variant, but had since largely recovered. Longer-term advanced-economy government bond yields had declined.

43 Market contacts were expecting Bank Rate to rise in the coming months. In the days running up to the MPC's December meeting, most contacts had expected Bank Rate to remain at 0.1% at this meeting. Following the UK CPI release on 15 December, however, market pricing had become more finely balanced between Bank Rate remaining at 0.1% and an increase of 15 basis points at this meeting.

44 As of 15 December 2021, the total stock of assets held in the Asset Purchase Facility had reached £893 billion, including £149 billion of the £150 billion programme of UK government bond purchases announced on 5 November 2020. Including the final gilt purchase auction that was being conducted on 15 December, the programme was due to be completed by the time of the Committee's December policy announcement. The Committee had also been briefed by Bank staff on progress towards investing the cash flows associated with reductions in the stock of sterling non-financial investment-grade corporate bond purchases held by the Asset Purchase Facility back into eligible corporate bonds, which had commenced in November 2021.

45 The number of Covid cases in the United Kingdom had picked up in the days leading up to the MPC's December meeting and, upon the identification of the Omicron variant, measures had been put in place in England and had been extended in the devolved nations. On 12 December, the Coronavirus alert level had been raised to level four, and the UK Government had announced a plan for all those eligible in England to be offered a booster vaccine by the end of this year, while offering additional support to Devolved Administrations to accelerate their vaccination programmes.

46 Bank staff had revised down their expectations for the level of UK GDP in 2021 Q4 by around ½% since the November *Report*, leaving GDP around 1½% below its pre-Covid level. Growth in many sectors had continued to be restrained by disruption in supply chains and shortages of labour. The impact of the Omicron variant, associated additional measures introduced by the UK Government and Devolved Administrations, and voluntary social distancing would push down on GDP in December and in 2022 Q1. The experience since March 2020 suggested that successive waves of Covid appeared to have had less impact on GDP, although there was uncertainty around the extent to which that would prove to be the case on this occasion. There had already been some tentative signs that UK economic activity had started to be affected by the emergence and spread of Omicron. As in previous Covid waves, headline GDP was still likely to be affected significantly by the ways in which public-sector output was measured in the UK national accounts.

47 The Labour Force Survey unemployment rate had fallen to 4.2% in the three months to October, while the number of payrolled employees had continued to rise strongly in November. There was little sign in the available data that the closure of the Coronavirus Job Retention Scheme at the end of September had led to a weakening in the labour market. The LFS unemployment rate was now expected to fall to around 4% in 2021 Q4, compared with the 4½% projection in the November *Report*. Abstracting from the risks from the impact of the Omicron variant, it was possible that the unemployment rate could fall further over coming months if hiring continued to keep pace with the current elevated levels of vacancies. Any weakness in demand related to the new variant could offset those forces to some extent.

48 Bank staff continued to estimate that underlying earnings growth had remained above pre-pandemic rates, and the Committee continued to see upside risks around the projection for pay in the November *Report*. The REC permanent staff salaries index and job-to-job flows had both increased to record highs, and contacts of the Bank's Agents expected strength in consumer price inflation to encourage workers to demand higher pay settlements.

49 Twelve-month CPI inflation had risen from 3.1% in September to 5.1% in November, 0.6 percentage points higher than had been expected at the time of the November *Report*, and triggering the exchange of open letters between the Governor and the Chancellor of the Exchequer that was being published alongside this monetary policy announcement. Core inflation had also risen to 4.0% in November. Relative to the November *Report* projection, there had been significant upside news in core goods and, to a lesser extent, services price inflation.

50 Bank staff expected inflation to remain around 5% through the majority of the winter period, and to peak at around 6% in April 2022, with that further increase accounted for predominantly by the lagged impact on utility bills of developments in wholesale gas prices. Indicators of cost and price pressures had remained at historically elevated levels recently, and contacts of the Bank's Agents expected further price increases next year driven in large part by pay and energy costs. CPI inflation was still expected to fall back in the second half of next year.

51 Since the Committee's previous meeting, medium-term measures of UK financial market inflation compensation had remained above their average levels over the past decade. In part, that was likely to reflect market participants' somewhat higher central expectations for inflation. Measures of medium to longer-term household inflation expectations had picked up over recent quarters, with the Citi/YouGov five to ten-year ahead measure remaining above its historical average, while the Bank/Kantar five-year ahead measure was still slightly below its historical average though there had been a break in this series in early 2020. The median responses in surveys of professional forecasters had remained consistent with CPI inflation being close to target in the medium term. Overall, and as set out in Box C in the November *Report*, the MPC judged that inflation expectations remained well anchored in the United Kingdom at present. The Committee would, nevertheless, continue to monitor very closely the risk that domestic and global demand and cost pressures could affect medium-term inflation expectations, and so wage and price setting.

52 In the run-up to its policy decision, the Committee had been briefed by the Chief Medical Officer for England on recent Covid developments, including the risks to public health from the Omicron variant.

53 The Committee discussed the possible implications of recent Covid developments for the economic outlook. The MPC had noted previously the risks to the economy from a drop in vaccine effectiveness arising from viral mutations, although it was unclear currently to what extent the Omicron variant would lead to a decline in vaccine protection against severe disease. Given the clear signs of increased transmissibility for the new variant, there was the potential for a very high number of infections over a very short period.

54 It was important to note that the current position of the global and UK economies was materially different compared with prior to the onset of the pandemic, including the elevated levels of consumer price inflation. Global inflationary pressures had been influenced significantly by the shift in spending from services to durable goods that the pandemic had induced. In the MPC's November *Report* forecast, it had been assumed that a rebalancing of demand would lead to a gradual reduction in the inflation rate, and in some cases the level, of the prices of traded goods. The possibility of renewed social distancing meant that this rebalancing was now more likely to be delayed and so global price pressures might persist for longer, although there were limits to how

much further households' stocks of durables were likely to rise and the responses of fiscal policy globally to the new variant was uncertain. A potential worsening of global supply chain disruption could also push up on inflationary pressures. For example, China's current zero-Covid strategy could lead to renewed disruptions at Chinese factories and ports, and could affect shipping costs. Against that, aggregate demand could slow, reducing inflationary pressures, particularly for some consumer-facing services, and any change in expectations of future demand might lead to some loosening of labour market conditions. Demand conditions could nevertheless remain strong if households deployed savings that had been built up during the course of the pandemic to a greater extent than had been assumed in the November *Report*. Overall, the balance of these effects on inflation was unclear.

55 So far, successive waves of Covid had tended to have less impact on GDP and consumer spending than previous waves, but there was uncertainty around the extent to which that would prove to be the case on this occasion. Progressively more limited reductions in mobility and social interactions might have reflected the successful roll-out of vaccines and the protection that these offered against the Delta variant. The emergence of a new, partially vaccine-resistant Covid variant might therefore have a significant negative impact on consumer confidence and on economic behaviour. There could, however, also be limits to the extent to which households would adjust their behaviour further. For example, a large number of employees had continued to work from home prior to the recent change in government guidance, growth in consumer spending on restaurants had continued to be supported by sales of take-away and delivery food in addition to seated dining, and online retail sales had remained strong. More generally, spending less on one category of consumption did not necessarily mean a like-for-like reduction in total spending. Such aggregate consumption decisions should be more closely related to household expectations of future income, including expectations beyond the point at which the pandemic was likely to be at its immediate peak.

56 The outlook for UK activity, and the balance of the effects of the Omicron variant on demand and supply, would also depend on the responses of other policymakers in the United Kingdom and abroad.

57 The Committee turned to its immediate policy decision.

58 The MPC's remit was clear that the inflation target applies at all times, reflecting the primacy of price stability in the UK monetary policy framework. The framework also recognised that there will be occasions when inflation would depart from the target as a result of shocks and disturbances. In the recent unprecedented circumstances, the economy had been subject to very large and repeated shocks. Given the lag between changes in monetary policy and their effects on inflation, the Committee, in judging the appropriate policy stance, would as always focus on the medium-term prospects for inflation, including medium-term inflation expectations, rather than factors that were likely to be transient.

59 At its November meeting, the Committee had judged that, provided the incoming data, particularly on the labour market, were broadly in line with the central projections in the November *Monetary Policy Report*, it would be necessary over coming months to increase Bank Rate in order to return CPI inflation sustainably to the 2% target. Recent economic developments suggested that these conditions had been met. The labour market was tight and had continued to tighten, and there were some signs of greater persistence in domestic

cost and price pressures. Although the Omicron variant was likely to weigh on near-term activity, its impact on medium-term inflationary pressures was unclear at this stage.

60 At this meeting, most members of the Committee judged that an immediate, small increase in Bank Rate was warranted. Although the conditions for tightening set out in November had been met, the decision at this meeting was finely balanced because of the uncertainty around Covid developments. There was some value in waiting for further information on the degree to which Omicron was likely to escape the protection of current vaccines and on the initial economic effects of this new wave. There was, however, also a strong case for tightening monetary policy now, given the strength of current underlying inflationary pressures and in order to maintain price stability in the medium term. The economic impact of the new variant could, in some scenarios, increase these inflationary pressures further. Moreover, maintaining the current monetary policy stance when CPI inflation was materially above the 2% target and the output gap appeared to be closed might cause medium-term inflation expectations to drift up further.

61 One member of the Committee judged that, were it not for the emergence of the Omicron variant, an increase in Bank Rate could have been appropriate at this meeting. However, the significant uncertainty introduced by Omicron warranted waiting until February for more clarity before considering any change in Bank Rate. UK output remained below its 2019 Q4 level and further below the trend for potential. The new variant and renewed voluntary social distancing would unambiguously slow economic activity, but would have two-sided effects on inflation. The overall effect of Omicron on the short-term trade-off between inflation and output, and on the medium-term prospects for inflation, would depend critically on the transmissibility, vaccine resistance and severity of the variant, but also on the overall policy response, both domestically and abroad. Some scenarios would call for tighter monetary policy, while others would require a somewhat longer period of accommodation. In line with risk management concerns owing to the asymmetry of available monetary policy tools, this member preferred to wait for further evidence that the recovery remained entrenched, and was not threatened materially by the new variant, before tightening monetary policy.

62 The MPC would review developments, including emerging evidence on the implications for the economy of the Omicron variant, as part of its forthcoming forecast round ahead of the February 2022 *Monetary Policy Report*. The Committee would, as always, continue to focus on the medium-term prospects for inflation. The Committee continued to judge that there were two-sided risks around the inflation outlook in the medium term, but that some modest tightening of monetary policy over the forecast period was likely to be necessary to meet the 2% inflation target sustainably. The Committee would reach its assessment on the balance of the risks to medium-term inflation in light of the relevant data as they emerged.

63 The Chair invited the Committee to vote on the propositions that:

Bank Rate should be increased by 0.15 percentage points, to 0.25%;

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 £20 billion;

The Bank of England should maintain the stock of UK government bond purchases, financed by the issuance of central bank reserves, at £875 billion.

Eight members (Andrew Bailey, Ben Broadbent, Jon Cunliffe, Jonathan Haskel, Catherine L Mann, Huw Pill, Dave Ramsden and Michael Saunders) voted in favour of the first proposition. Silvana Tenreyro voted against this proposition, preferring to maintain Bank Rate at 0.1%.

The Committee voted unanimously in favour of the second and third propositions.

64 The following members of the Committee were present:

Andrew Bailey, Chair
Ben Broadbent
Jon Cunliffe
Jonathan Haskel
Catherine L Mann
Huw Pill
Dave Ramsden
Michael Saunders
Silvana Tenreyro

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 and Diana Harding were also present on 10 December, as observers for the purpose of exercising oversight functions in their roles as members of the Bank's Court of Directors.