BANK OF ENGLAND

Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 2 February 2022

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These are the minutes of the Monetary Policy Committee meeting ending on 2 February 2022.

They are available at https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2022/february-2022.

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 16 March will be published on 17 March 2022.

Monetary Policy Summary, February 2022

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 2 February 2022, the MPC voted by a majority of 5-4 to increase Bank Rate by 0.25 percentage points, to 0.5%. Those members in the minority preferred to increase Bank Rate by 0.5 percentage points, to 0.75%. The Committee voted unanimously for the Bank of England to begin to reduce the stock of UK government bond purchases, financed by the issuance of central bank reserves, by ceasing to reinvest maturing assets. The Committee also voted unanimously for the Bank of England to begin to reduce the stock of sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, by ceasing to reinvest maturing assets and by a programme of corporate bond sales to be completed no earlier than towards the end of 2023 that should unwind fully the stock of corporate bond purchases.

The Committee's updated central projections for activity and inflation are set out in the accompanying February *Monetary Policy Report*. The projections are conditioned on a market-implied path for Bank Rate that rises to around 1½% by the middle of 2023. Wholesale energy prices are assumed to follow their respective futures curves for the first six months of the projections and remain constant beyond that, in contrast to futures curves, which are downward sloping over coming years. There are material risks around this assumption.

Global and UK activity returned to their pre-Covid-19 (Covid) levels towards the end of last year. The emergence of the Omicron variant is expected to have depressed activity somewhat in December and January. But its economic impact is likely to be limited and of short duration, and UK GDP is expected to recover in February and March such that output returns to its pre-pandemic level once again by the end of the first quarter. The Labour Force Survey unemployment rate fell to 4.1% in the three months to November, and is expected to fall further in the near term, to 3.8% in 2022 Q1.

Beyond the near term, UK GDP growth is expected to slow to subdued rates. The main reason for that is the adverse impact of higher global energy and tradable goods prices on UK real aggregate income and spending. As a result, the unemployment rate is expected to rise to 5% and excess supply builds to around 1% by the end of the forecast period.

Underlying earnings growth is estimated to have remained above pre-pandemic rates, and is expected to strengthen over the coming year, to around 4¾%. This is consistent with the results of the Bank's Agents' annual pay survey, with the tight labour market, and with some temporary upward pressure on wage settlements from higher price inflation.

Twelve-month CPI inflation rose from 5.1% in November to 5.4% in December, almost 1 percentage point higher than expected at the time of the November *Report*. Inflation is expected to increase further in coming months, to close to 6% in February and March, before peaking at around 7¼% in April. This projected peak is around 2 percentage points higher than expected in the November *Report*. The projected overshoot of inflation relative to the 2% target mainly reflects global energy and tradable goods prices. The further rise in energy futures prices meant that Ofgem's utility price caps were expected to be substantially higher at the reset in April 2022. Core goods CPI inflation is also expected to rise further, due to the impact of global bottlenecks on tradable goods prices.

In the February *Report* central projection, upward pressures on CPI inflation are expected to dissipate over time, as global energy prices are assumed to remain constant after six months, and as global bottlenecks ease and tradable goods prices fall back a little. Underlying wage growth is also projected to ease from 2023, as the labour market loosens gradually and inflation declines. Conditioned on the rising market-implied path for Bank Rate and the MPC's current forecasting convention for future energy prices, CPI inflation is projected to fall back to a little above the 2% target in two years' time and to below the target by a greater margin in three years.

In an alternative scenario that is conditioned on energy prices following forward curves throughout the forecast period and as set out in the February *Report*, excess supply is around ½ percentage point lower in the medium term than in the MPC's central projection, and CPI inflation is around ¾ percentage point below the 2% target in two and three years' time.

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. In particular, should recent movements prove persistent, the sharp rises in prices of global energy and tradable goods of which the United Kingdom is a net importer will necessarily weigh on UK real aggregate income and spending. This is something monetary policy is unable to prevent. The role of monetary policy is to ensure that, as such a real economic adjustment occurs, it does so consistent with achieving the 2% inflation target sustainably in the medium term, while minimising undesirable volatility in output.

Given the current tightness of the labour market and continuing signs of greater persistence in domestic cost and price pressures, the Committee judges that an increase in Bank Rate of 0.25 percentage points is warranted at this meeting.

Consistent with the MPC's guidance set out in the August 2021 *Report*, the Committee agrees at this meeting that the Bank of England should cease to reinvest any future maturities falling due from its stock of UK government bond purchases. This reflects the MPC's intention to reduce its holdings of government bonds in a gradual and predictable manner.

In addition, the Committee agrees that the Bank of England should cease to reinvest any maturities falling due from its stock of sterling non-financial investment-grade corporate bond purchases, and that it should initiate a programme of corporate bond sales to be completed no earlier than towards the end of 2023 that should unwind fully the stock of corporate bond purchases.

The decision to initiate the programme of corporate bond sales reflects the specific characteristics of the corporate bond market and the MPC's involvement in it, and should not be taken as a signal regarding the commencement, scale or duration of any potential future UK government bond sales programme.

The Committee reaffirms that it will consider beginning the process of actively selling UK government bonds only once Bank Rate has risen to at least 1%, and depending on economic circumstances at the time. The Committee also reaffirms its preference in most circumstances to use Bank Rate as its active policy tool when adjusting the stance of monetary policy.

The extent of any further tightening in monetary policy will depend on the medium-term prospects for inflation. The MPC judges that, if the economy develops broadly in line with the February *Report* central projections, some further modest tightening in monetary policy is likely to be appropriate in the coming months. The Committee continues to judge that there are two-sided risks around the medium-term inflation outlook, primarily from wage developments on the upside and from energy and global tradable goods prices on the downside. The Committee will update 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 2 February 2022

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

The international economy

2 UK-weighted global GDP was estimated to have grown by 0.8% in 2021 Q4, as had been expected in the November *Monetary Policy Report*. In 2022 Q1, global GDP was expected to grow more slowly than had been anticipated in the November *Report*, as the Omicron Covid variant had led to renewed restrictions and voluntary social distancing in many countries. However, the uncertainty relating to the economic impact of Omicron had declined, and its economic consequences were likely to be more limited and of shorter duration than had been anticipated at the time of the MPC's December meeting. Global cost pressures, arising from the strength in goods demand and supply chain disruptions as well as high energy prices, had remained elevated and had also weighed on activity over past months. Strong demand for goods, in particular in the United States, had appeared to have been a more important determinant of global bottlenecks than supply chain disruptions over recent months.

3 According to the preliminary flash estimate, euro-area GDP had increased by 0.3% in 2021 Q4, such that output had returned to its 2019 Q4 level. This was weaker than had been expected in the November *Report*, due to tighter restrictions to address rising Covid case numbers in November and December in several countries, driven initially by the Delta variant and subsequently by Omicron. The unemployment rate had fallen to 7.0% in December, a historical low. Omicron case numbers had increased going into 2022 and, as a result, euro-area output was expected to contract slightly in the first quarter. Notwithstanding restrictions starting to ease in some countries, recent indicators had pointed to weakness in Covid-sensitive sectors with the flash services activity PMI falling back in January. The manufacturing output PMI had picked up, possibly suggesting some stabilisation in supply constraints, particularly in Germany.

4 According to the advance estimate, US GDP had grown by 1.7% in 2021 Q4, implying that output had been around 3% above its 2019 Q4 level. This had reflected a stronger recovery than had been anticipated in the November *Report*, as the economic impact of the Delta variant had waned. Growth in the fourth quarter had been accounted for primarily by stockbuilding. Consumption had also supported growth, and there had been evidence for a continuing rotation of household spending from goods to services. The labour market had appeared tight at the end of 2021. The unemployment rate had fallen to 3.9% in December, the lowest level since February 2020, as participation rates had remained below pre-Covid levels and the number of job vacancies had continued to be high relative to historical levels. More recent high-frequency card spending data suggested that there had been a relatively temporary disruption to spending related to Omicron around the turn of the year, with limited restrictions in place. In 2022 Q1, GDP was expected to grow by 0.5%.

5 In China, GDP had increased by 1.6% in 2021 Q4, stronger than had been expected in the November *Report*. Year-on-year industrial production growth had increased in December, reflecting an easing of power shortages and of some input constraints, as well as strong external demand. However, consumption indicators had continued to be somewhat weaker than measures of production, with year-on-year retail sales growth slowing, as localised Covid outbreaks and associated restrictions weighed on domestic demand. The recent outbreaks appeared to have had a relatively limited impact on the supply capacity of the economy but, looking ahead, there was uncertainty as to whether the more transmissible Omicron variant might cause greater supply disruptions, to the extent that China maintained its current Covid strategy. The housing market had continued to slow.

6 Consumer price inflation had remained elevated in the euro area and the United States. Euro-area annual HICP inflation had increased to 5.1% in January, significantly above market expectations immediately ahead of the release, while core inflation had fallen to 2.3%. In the United States, annual PCE inflation had risen to 5.8% in December, with core inflation increasing to 4.9%. High energy prices had driven most of the pickup in consumer price inflation over the fourth quarter in the euro area, while price pressures were more broadly based in the United States, with strong contributions from energy, cars, accommodation and other core goods. This suggested that, in addition to high energy prices, pressures from global bottlenecks due to strong demand for goods and inelastic supply had been passing through to consumer prices. There had also been some divergence in wage growth between the United States and the euro area. According to the Federal Reserve Bank of Atlanta's measure, US wage growth had continued to increase in the fourth quarter, to somewhat above its pre-Covid rate, while wage growth in the euro area had remained muted in the third quarter.

7 The MPC discussed the central case for, as well as risks to, the global inflation outlook. In the near term, there would likely be further pass-through to consumer price inflation from past cost increases. Since the MPC's December meeting, signals from cost indicators had been mixed. Energy prices had been volatile. Wholesale gas spot prices had initially fallen back in Europe from their peak in mid-December, but had recently risen again amid increasing geopolitical tensions. The Brent oil spot price had risen by $19 per barrel since the MPC's previous meeting, to $91. Measures of shipping costs had been mixed, with some easing and others increasing once more. Indices of global input prices and delivery times had plateaued, suggesting some stabilisation in global bottlenecks at high levels. Overall, global bottlenecks were expected to ease over the next twelve months as spending in the United States rotated back to services, a little later than had been anticipated in the November *Report*. There was, however, a risk that the demand rotation could be delayed further, for example if consumer preferences had shifted more permanently. Supply chains could also be further disrupted in the event of widespread factory and port closures in China in response to Covid developments. Should these risks materialise, consumer prices could rise further than anticipated. Alternatively, it was possible that global cost pressures abated more quickly and to a greater extent in the medium term than expected, in which case consumer price inflation might moderate at a faster pace as well.

Monetary and financial conditions

8 Since the MPC's previous meeting, advanced-economy government bond yields had risen significantly. Ten-year yields had increased by around 35 to 60 basis points in the United States, euro area and United

Kingdom, reaching their highest levels since the onset of the pandemic. These increases had been accounted for primarily by real rates. The increases in nominal yields had reflected higher estimated term premia across countries, with a high degree of comovement between yields across different economies.

9 The path for market-implied policy rates in the United States had risen significantly since the MPC's previous meeting. At its 26 January meeting, the FOMC had left its target range for the federal funds rate unchanged and had continued to reduce the monthly pace of its asset purchases, as well as publishing additional information regarding its principles for significantly reducing the size of the Federal Reserve's balance sheet. The market-implied policy rate in the United States reached around 1¼% by end-2022, around 50 basis points higher than immediately prior to the MPC's December meeting. In the euro area, the near-term market-implied path for policy rates had moved down a little over the same period. At its meeting on 16 December, the ECB Governing Council had left its key policy interest rates unchanged, and had announced a gradual reduction in the pace of net asset purchases.

10 In the United Kingdom, market-implied expectations for the path of Bank Rate over the year ahead had risen, with market pricing consistent with an increase in Bank Rate of 0.25 percentage points, to 0.5%, at this MPC meeting. The February *Monetary Policy Report* was conditioned on a market-implied path for Bank Rate, based on the 15-working day average to 26 January, that rose to around 1½% by mid-2023. In the immediate run-up to the MPC's February meeting, the market-implied path for Bank Rate had reached around 1.7% by mid-2023. The results of the Bank of England's new Market Participants Survey, which would be published for the first time on the Friday following the release of these minutes, had painted a broadly similar picture of Bank Rate expectations: respondents had widely expected a 0.25 percentage point increase in Bank Rate at this meeting; a large majority expected Bank Rate to reach 1% within the next year; and respondents assessed that the balance of risks around this near-term path was skewed to the upside. Respondents expected reinvestments of the Bank's holdings of UK government bonds to cease after the anticipated Bank Rate increase at this meeting.

11 Medium-term inflation compensation measures in the United Kingdom had increased slightly since the MPC's previous meeting and had remained above their average levels of the past decade, in contrast to similar measures in the United States and the euro area, which had been around their average levels of the past decade. As the Committee had discussed previously, interpreting UK medium-term inflation compensation measures was not straightforward. 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 these above-average levels of medium-term inflation compensation measures, alongside other factors. This was consistent with results from the Market Participants Survey, which had suggested that respondents attributed these levels in part to elevated inflation expectations, but also to technical factors, such as those arising from the fact that inflation markets were used for hedging large pension liabilities, and an upside balance of risks around the inflation outlook.

12 The sterling effective exchange rate had risen by around 2% since the previous MPC meeting. The US dollar had, in contrast, fallen by around ½%, despite a relatively large increase in US government bond yields.

13 Equity prices had fallen after the MPC's previous meeting, before recovering. The initial fall had reflected the increase in government bond yields, as well as the impact of geopolitical developments. Overall, equity prices had ended the period lower in the United States, while in the United Kingdom they had increased somewhat, cushioned by an estimated fall in equity risk premia. This in part had reflected the composition of the FTSE All Share index, including its skew towards sectors that had been supported by the recent rise in energy prices. Across countries, there had been stronger performance in those sectors more exposed to Covid, relative to those more exposed to higher interest rates. There had been less adjustment in the corporate bond market, as spreads had remained at historically low levels, having reversed the modest increases seen in response to the initial emergence of Omicron.

14 Lending rates on mortgages with loan-to-value (LTV) ratios at or below 75% had increased further since the MPC's previous meeting. This was broadly consistent with a lagged response to the increases in risk-free rates in the fourth quarter of 2021, with around half of those increases having passed through to lending rates. The subsequent further increases in risk-free rates seen since the December MPC meeting would be expected to feed through to mortgage lending rates in due course. Other components of household borrowing, such as credit cards and personal loans had been less sensitive, as would be expected.

Demand and output

15 UK quarterly GDP growth in 2021 Q3 had been revised down slightly in the Quarterly National Accounts, from 1.3% to 1.1%. The level of GDP had, however, been revised up by around ½%, with that news more than accounted for by a higher path of household consumption throughout the pandemic. In the third quarter, consumption had risen by 2.7%, while the saving ratio had fallen back to 8.3%. Business investment had fallen by 2.5% in Q3, with particular weakness in the air transport sector, and had remained well below its pre-Covid level in 2019 Q4.

16 GDP was estimated to have risen by 0.9% in November, stronger than had been expected by Bank staff. Combined with the upward revisions to GDP, this meant that, prior to the onset of the Omicron variant, aggregate activity had regained its pre-pandemic level for the first time. GDP had been almost 1% higher than expected at the time of the November *Monetary Policy Report*. Within the November output data, activity had been stronger than expected across most sectors of the economy, including consumer-facing, transport and professional services. There had also been tentative signs in the manufacturing and construction sectors that supply disruptions were starting to ease, although monthly data could be volatile.

17 Bank staff expected GDP to have fallen by around ½% in December, largely due to the impact of the Omicron variant towards the end of the month, but to have risen by just over 1% during 2021 Q4 as a whole. Retail sales volumes had fallen quite sharply in December, according to official data, in part reflecting the unwind of previous strength, as consumers appeared to have brought forward some purchases ahead of the holiday season, and as Omicron had weighed on activity. Contacts of the Bank's Agents had reported that shortages of some goods due to continuing supply-chain issues had not constrained aggregate spending by as

much as had been anticipated. Nevertheless, staff shortages, exacerbated by absences due to sickness or self-isolation, were reported to have curtailed activity across a number of sectors.

18 Having reached a very high level around the turn of the year, the number of Covid cases had fallen back, and had then appeared to have stabilised. On 21 December, the Chancellor of the Exchequer had announced that additional support would be available for businesses who were impacted by the Omicron variant, including one-off grants of up to £6,000 per premise for businesses in the hospitality and leisure sectors in England, and that the Government would cover the cost of Statutory Sick Pay for Covid-related absences for small and medium-sized employers across the United Kingdom. In the run-up to this MPC meeting, the UK Government and Devolved Administrations had announced a number of relaxations to Covid measures, some of which had been put in place in response to the Omicron variant. These had included the lifting of Plan B measures in England during the second half of January, and the removal of post-arrival testing requirements for fully vaccinated travellers into the United Kingdom from 11 February.

19 Recent high-frequency indicators suggested that activity had rebounded somewhat since early January, including in consumer-facing services and work-related travel. This was consistent with intelligence from the Bank's Agents that the peak economic impacts of the Omicron variant had passed quickly. GfK consumer confidence had nevertheless fallen in January, probably due to initial concerns around the impact of Omicron. Despite the incipient squeeze on real household disposable incomes, households' views of their own financial situation had, so far, held up relatively well. Contacts of the Bank's Agents had noted, however, that they expected pressure on household incomes to dampen consumer spending in the coming months. Overall, Bank staff expected GDP to recover further in February and March, such that the economy was projected to return to its pre-pandemic level of activity once again by the end of the first quarter, and that GDP on average would be unchanged between 2022 Q1 and 2021 Q4. Market sector GDP was expected to surpass its November 2021 level by March.

20 Although the number of companies reporting skilled labour shortages as a constraint on output in the January CBI Industrial Trends survey had remained very elevated, the number of companies reporting materials shortages as a factor limiting production had fallen back somewhat from its highest level since the mid-1970s, and the January manufacturing PMIs had suggested that supply constraints were not worsening as much as in previous months. Contacts of the Bank's Agents expected only a slow improvement in supply chain disruption through 2022, and some continued to judge that problems could persist into 2023. There had also been increasing reports of slower investment growth due to shortages of goods, machinery and labour. There had, nevertheless, been widespread strength in investment intentions reported to the Agents, with contacts highlighting the reinstatement of projects that had been paused during the pandemic, and the need to increase capacity to meet demand. After weakening in December, the January Decision Maker Panel had reported a smaller drag from Covid on business investment over the first half of this year.

Supply, costs and prices

21 The Labour Force Survey (LFS) unemployment rate had fallen to 4.1% in the three months to November, 0.4 percentage points lower than had been expected at the time of the November *Monetary Policy Report*. The LFS employment rate had been broadly as expected, however, as inactivity had unexpectedly risen slightly. The number of inactive people who reported wanting a job had continued to fall. Her Majesty's Revenue and Customs (HMRC) employee payrolls had risen by a further 184,000 in the single month of December, although these initial estimates had tended to be revised down somewhat. Bank staff judged that both the LFS employee and HMRC payroll series were around their 2019 Q4 levels after accounting for an unusually high number of individuals having switched from self-employment and onto payrolls, associated in part with tax reforms. Self-employment had remained weak even accounting for these estimates of switching, such that LFS employment was 1.4% below its 2019 Q4 level in the three months to November. Indicators of labour market tightness had nevertheless remained elevated. The ratio of vacancies to unemployment had increased to another record high since a consistent series had begun in 2001.

22 Bank staff expected the LFS unemployment rate to fall further to 3.8% in 2022 Q1, despite the spread of Omicron weighing on activity at the beginning of the quarter. The flash composite employment PMI for January had been broadly unchanged on the month, remaining well above its past historical average. The Bank's Agents had reported a modest easing in employment growth, in part due to recruitment difficulties having remained intense. High-frequency indicators of online vacancies had dipped during December and had begun to recover in January, but that profile had been comparable to the seasonal pattern prior to the pandemic. Instead of weaker labour demand, the main counterpart in the labour market to Covid-related weakness in activity had appeared to be an increase in staff absences due to sickness, self-isolation or caring responsibilities. The ONS Business Insights and Conditions Survey suggested that around 3% of the workforce had been absent for Covid-related reasons around the turn of the year. The Agents' contacts had begun to see a reduction in absences, however, and generally viewed Omicron as a temporary issue.

23 Growth in private-sector regular Average Weekly Earnings (AWE) had slowed to 4.1% in the three months to November on a year earlier, broadly in line with Bank staff expectations ahead of the release. Pay growth had been boosted by the mechanical effects of the Coronavirus Job Retention Scheme and changes in the composition of the workforce, but those effects had waned in recent months. Adjusting for these effects, Bank staff estimated that underlying private-sector regular pay growth had remained at around 4 to 4½%, above pre-pandemic rates of around 3 to 3½%. The median of pay growth based on HMRC payrolls data was around 3%, comparable to pre-pandemic rates, implying that recent pay awards had been more skewed towards the upside than in the recent past. That was broadly consistent with the Bank's Agents' contacts reporting that pay increases had been significantly higher for workers with skills in short supply.

24 In the February *Report* projection, underlying private-sector pay growth was expected to pick up further in coming quarters. A special survey of firms conducted by the Bank's Agents suggested that the average pay settlement was expected to rise to close to 5% in 2022, with the pickup broadly based across different sectors of the economy and firms of different sizes. Contacts had cited the ability to retain staff and recruit new workers, and increases in consumer price inflation, as factors that had pushed up their expectations for pay. The REC

permanent staff salaries index, which measured the monthly pay growth of new permanent hires, had also remained close to record highs in December. Headline AWE growth was expected to be somewhat lower than the underlying rate, as the past boost to pay from compositional effects was assumed to continue to fade, although there was uncertainty around the precise scale and speed of any such unwind.

25 Twelve-month CPI inflation had risen to 5.4% in December, almost 1 percentage point above the November *Report* forecast. The upside news had been spread across a number of components, particularly within core goods. Strength in core goods prices, alongside higher energy prices, had also accounted for much of the absolute overshoot in inflation relative to the 2% target. Services price inflation had moved further above its pre-Covid rate. Price increases had been particularly acute for second-hand cars and hospitality, replicating trends in the United States.

26 CPI inflation was projected to increase further in coming months, to close to 6% in February and March and peaking at around 7¼% in April when higher utility price caps were due to be implemented. This projected peak was around 2 percentage points higher than had been expected in the November *Report*. In addition to the upside news in the CPI data to December, wholesale gas and electricity futures prices had increased further, putting upward pressure on utility prices. The costs of the Supplier of Last Resort mechanism, covering the losses that energy companies had incurred from taking on customers from failed suppliers, were also expected to begin to be passed on to household energy bills. The annual ONS update of the CPI weights was anticipated by Bank staff to lead to an increase in CPI inflation in the near term, in part due to greater weight being placed on energy prices. Certain contract prices, such as for telecommunication services, that were indexed to consumer price measures were also due to increase in coming months.

27 Survey indicators of costs and prices, such as the flash composite input and output price PMIs for January, had remained at historically elevated levels. The Bank's Agents had reported that the costs of some raw materials and shipping rates on some routes appeared to be stabilising, but that higher energy and wage costs were putting additional upward pressure on prices. The Agents' pay survey had suggested that around 70% of companies were expecting to increase their prices due to current wage pressures, although that share was lower among consumer-facing firms.

28 Measures of households' and companies' short-term inflation expectations had risen further since the MPC's previous meeting. The Citi/YouGov household measure of expectations for the year ahead had increased from 4.0% in December to 4.8% in January, although the five-to-ten year ahead measure was unchanged. Respondents to the Decision Maker Panel had increased their expectations for their own price increases over the next twelve months from 4.2% in the survey covering the three months to November to 4.5% for the three months to January. Professional forecasters continued to expect CPI inflation to be close to the 2% target two and three years ahead.

The immediate policy decision

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

30 The Committee reviewed recent developments against the backdrop of its updated central projections for activity and inflation as set out in the accompanying February *Monetary Policy Report*. The projections were conditioned on a market-implied path for Bank Rate that rose to around 1½% by the middle of 2023. Wholesale energy prices were assumed to follow their respective futures curves for the first six months of the projections and remain constant beyond that, in contrast to futures curves, which were downward sloping over coming years. There were material risks around this assumption.

31 UK-weighted world GDP in 2021 Q4 was estimated to have grown in line with expectations in the November *Report*. In 2022 Q1, global GDP was expected to grow more slowly, but the uncertainty relating to the economic impact of Omicron had declined, and its economic consequences were likely to be more limited and of shorter duration than had been anticipated at the time of the MPC's December meeting. In the February *Report* projections, global activity continued to grow thereafter, but was restrained by higher global energy prices over the forecast period, and by the impact of ongoing supply chain constraints for tradable goods over the coming year.

32 Consumer price inflation had risen further in the United States and the euro area since the Committee's previous meeting. Global cost pressures, arising from the strength in goods demand and supply chain disruptions as well as high energy prices, had also remained elevated. Wholesale gas spot prices had initially fallen back in Europe from their peak in mid-December, but had recently risen again amid increasing geopolitical tensions. Oil prices had risen significantly. Strong demand for goods, in particular in the United States, had appeared to have been a more important determinant of global bottlenecks than supply chain disruptions over recent months. In the February *Report* projections, world export prices were expected to rise a little further in the near term. As global bottlenecks eased, global tradable goods prices were expected to fall a little over the forecast period, though to remain well above their pre-pandemic levels.

33 Since the MPC's previous meeting, advanced-economy government bond yields had increased significantly. Market-implied expectations for the path of Bank Rate had risen, with market pricing consistent with an increase in Bank Rate of 0.25 percentage points, to 0.5%, at this MPC meeting. The results of the Bank of England's Market Participants Survey, which would be published for the first time on the Friday following the release of these minutes, had painted a broadly similar picture of Bank Rate expectations.

34 Having reached a very high level around the turn of the year, the number of Covid cases had fallen back in the United Kingdom, and had then appeared to have stabilised. In the run-up to this MPC meeting, the UK Government and Devolved Administrations had announced a number of relaxations to Covid measures, some of which had been put in place in response to the Omicron variant. The MPC's projections were conditioned on the assumptions that no material restrictions on economic activity were re-imposed, and that there was no further widespread voluntary social distancing, following this wave.

35 UK GDP was estimated to have risen by 0.9% in November. Combined with upward revisions to GDP, this meant that, prior to the emergence of the Omicron variant, aggregate activity had regained its pre-pandemic level for the first time. The Omicron variant was expected to have depressed activity somewhat in December and January. But its economic impact was likely to be limited and of short duration, and GDP was expected to recover in February and March such that output returned to its pre-pandemic level once again by the end of the first quarter.

36 The Labour Force Survey unemployment rate had fallen to 4.1% in the three months to November, 0.4 percentage points lower than had been expected at the time of the November *Report*. It was expected to fall further in the near term, to 3.8% in 2022 Q1, despite the spread of Omicron weighing on activity at the beginning of the quarter. The ratio of vacancies to unemployment had increased, to another record high. Most indicators of the balance of demand and supply in the economy suggested that there was currently a small margin of excess demand across the economy as a whole.

37 Beyond the near term, UK GDP growth was expected to slow to subdued rates. The main reason for that was the adverse impact of higher global energy and tradable goods prices on UK real aggregate income and spending.

38 Consumption growth was expected to slow, as households cut back on spending in the face of the material adverse effects on their real incomes from the sharp rises in global energy and tradable goods prices, and the planned increase in national insurance contributions in April 2022. Although consumption growth therefore slowed materially over the first two years of the forecast period, it remained above income growth. That reflected an assumption that households would spend some of the significant additional savings that they had accumulated, in aggregate, during the pandemic. As a result, the household saving rate was expected to fall from 8.3% in 2021 Q3 to below 4% from the end of 2022. There were risks in both directions around this projection. Given the windfall nature of the excess savings built up during the course of the pandemic, households could be more willing to spend out of these to support their level of real consumption. Set against that, existing savings were more concentrated among higher earners, who might generally spend proportionately little out of their savings. Developments in energy prices in particular could also disproportionately affect those households with lower savings.

39 In the February *Report* projections, a margin of excess supply was expected to emerge later this year and to build over the forecast period. In part, that was accounted for by some slack in the labour market, with the unemployment rate expected to rise to around 5% by the end of the projection.

40 Underlying earnings growth was estimated to have remained above pre-pandemic rates, and was expected to strengthen over the coming year, to around 4¾%. This was consistent with the results of the Bank's Agents' annual pay survey, with the tight labour market, and with some temporary upward pressure on wage settlements from higher price inflation.

41 Twelve-month CPI inflation had risen from 5.1% in November to 5.4% in December, almost 1 percentage point higher than had been expected at the time of the November *Report*. The upside news had been spread across a number of components, particularly within core goods. Strength in core goods prices, alongside higher

energy prices, had accounted for much of the absolute overshoot in inflation relative to the 2% target. Services price inflation had moved further above its pre-Covid rate.

42 CPI inflation was expected to increase further in coming months, to close to 6% in February and March, before peaking at around 7¼% in April. This projected peak was around 2 percentage points higher than expected in the November *Report*. Three-quarters of the projected increase in inflation between December and April was expected to reflect higher contributions from energy and goods prices. Survey indicators of costs and prices had remained at historically elevated levels.

43 The HM Treasury representative had briefed the Committee on the Government's policy plans in response to Ofgem's forthcoming price cap announcement.

44 In the February *Report* central projection, upward pressures on CPI inflation were expected to dissipate over time, as global energy prices were assumed to remain constant after six months, and as global bottlenecks eased and tradable goods prices fell back a little. Underlying wage growth was also projected to ease from 2023, as the labour market loosened gradually and inflation declined. Conditioned on the rising market-implied path for Bank Rate and the MPC's current forecasting convention for future energy prices, CPI inflation was projected to fall back to a little above the 2% target in two years' time and to below the target by a greater margin in three years. In projections conditioned on the alternative assumption of constant interest rates at 0.5%, CPI inflation was expected to be 2.6% and 2.1% in two and three years' time respectively.

45 In an alternative scenario that was conditioned on the market-implied path for Bank Rate and energy prices following forward curves throughout the forecast period, and as was set out in the February *Report*, excess supply was around ½ percentage point lower in the medium term than in the MPC's central projection, and CPI inflation was around ¾ percentage point below the 2% target in two and three years' time.

46 Measures of households' and companies' short-term inflation expectations had risen further since the MPC's previous meeting. Measures of inflation expectations two to three years ahead, as well as some longer-term measures derived from household surveys and financial markets, had also increased in recent months, but by less than short-term measures. Professional forecasters continued to expect CPI inflation to be close to the 2% target two and three years ahead. A risk to the inflation outlook was that longer-term inflation expectations evolved such that wage and price setting were not consistent with inflation returning to the 2% target in the medium term. Overall, the MPC judged that inflation expectations remained well anchored at present. The Committee would, nevertheless, continue to monitor measures of inflation expectations very closely.

47 In Box A of the August 2021 *Monetary Policy Report*, the Committee had set out its strategy for the mix of monetary policy instruments to deliver tighter policy, including its preference in most circumstances to use Bank Rate as its active policy tool when adjusting the stance of monetary policy. The Committee had noted that it intended to begin to reduce the stock of UK government bonds, by ceasing to reinvest maturing assets, when Bank Rate reached 0.5% and if appropriate given the economic circumstances. This would have the benefit of providing a predictable and gradual path for the reduction in the stock of government bonds. The MPC would also consider actively selling some of the stock of government bonds only once Bank Rate had risen to at least

1%, and depending on economic circumstances at the time. The Box had stated that the MPC would take a separate decision on the corporate bond portfolio in due course.

48 In the run-up to this MPC meeting, the Committee had considered its strategy for reducing the stock of sterling non-financial investment-grade corporate bond purchases. It judged that ceasing reinvestments and, in addition, initiating a programme of corporate bond sales at the point Bank Rate reached 0.5%, would appropriately reflect the specific characteristics of the Corporate Bond Purchase Scheme (CBPS). It also judged that this would not have implications for the unwinding of the UK government bond portfolio, which would continue to be governed by the framework set out in Box A in the August *Report*.

49 The CBPS, at £20 billion, was far smaller than the stock of UK government bonds held by the APF, both in absolute terms and as a proportion of their respective markets. The MPC therefore judged that the impact on monetary conditions of unwinding the stock of corporate bonds, at a time when markets were functioning normally, was likely to be relatively small.

50 The Committee turned to its immediate policy decision.

51 The MPC's remit was clear that the inflation target applied at all times, reflecting the primacy of price stability in the UK monetary policy framework. The framework also recognised that there would 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. In particular, should recent movements prove persistent, the sharp rises in prices of global energy and tradable goods of which the United Kingdom was a net importer, would necessarily weigh on UK real aggregate income and spending. This was something monetary policy was unable to prevent. The role of monetary policy was to ensure that, as such a real economic adjustment occurred, it did so consistent with achieving the 2% CPI inflation target sustainably in the medium term, while minimising undesirable volatility in output.

52 Given the current tightness of the labour market and continuing signs of greater persistence in domestic cost and price pressures, all members of the Committee judged that an increase in Bank Rate was warranted at this meeting. Different members placed different weights on the arguments for an increase in Bank Rate of 0.25 or of 0.5 percentage points at this meeting.

53 Five members judged that a 0.25 percentage point increase in Bank Rate was warranted at this meeting. The February *Report* projections implied that some tightening in monetary policy was required to bring inflation back to the 2% target sustainably in the medium term. However, the forecast also incorporated a material trade-off related to the continuing global energy and tradable goods price shock, with CPI inflation expected to remain materially above the target in the first half of the forecast, at the same time as a margin of spare capacity was opening up. After the second year, conditioned on the market path for Bank Rate, CPI inflation was projected to fall below the target due to that widening margin of spare capacity. In the scenario in which energy prices followed their forward curves throughout the forecast period, inflation was projected to undershoot the target by ¾ percentage point in two and three years' time. These members recognised the risks from the possibility of stronger domestic wage and price pressures in the near term, but also saw a need to balance this against the potential for inflation to fall more quickly and to a greater extent than expected if energy and other

tradable goods prices followed a lower path than in the MPC's central projection. There was also a case for moving Bank Rate in small increments; a larger increase at this meeting could have an outsized impact on expectations for the further path of policy, which was already sufficient, in the central projection, to push inflation well below the target in year three of the forecast.

54 Four members judged that a 0.5 percentage point increase in Bank Rate was warranted at this meeting. Monetary policy had been very accommodative, and capacity pressures were now widespread, especially in the labour market. The projected path for CPI inflation was again being revised up over the first two years of the forecast period, while medium-term inflation expectations remained relatively high and on some measures had increased further. Companies responding to the Decision Maker Panel had indicated that they expected to raise prices significantly in 2022. The strong pickup in pay settlements reported to the Bank's Agents, and the recent broadening from goods price to services price inflation, suggested that these developments were now being reflected in domestic costs and prices, which could make CPI inflation more persistent than was expected in the February *Report* central projection. Monetary policy should tighten to a greater extent at this meeting in order to reduce the risk that recent trends in pay growth and inflation expectations became more firmly embedded and thereby help to bring inflation back to the target sustainably in the medium term.

55 Consistent with the MPC's guidance set out in the August 2021 *Report*, and given that financial markets were functioning normally, the Committee agreed at this meeting that the Bank of England should cease to reinvest any future maturities falling due from its stock of UK government bond purchases. This reflected the MPC's intention to reduce its holdings of government bonds in a gradual and predictable manner.

56 In addition, the Committee agreed that the Bank of England should cease to reinvest any maturities falling due from its stock of sterling non-financial investment-grade corporate bond purchases, and that it should initiate a programme of corporate bond sales to be completed no earlier than towards the end of 2023 that should unwind fully the stock of corporate bond purchases.

57 The decision to initiate this programme of corporate bond sales reflected the specific characteristics of the corporate bond market and the MPC's involvement in it, and should not be taken as a signal regarding the commencement, scale or duration of any potential future UK government bond sales programme. The Committee reaffirmed that it would consider beginning the process of actively selling UK government bonds only once Bank Rate had risen to at least 1%, and depending on economic circumstances at the time.

58 The Committee also reaffirmed its preference in most circumstances to use Bank Rate as its active policy tool when adjusting the stance of monetary policy. The Committee agreed that, as a matter of course, it would not continue to vote at each meeting on propositions regarding the stock of purchased assets, at least until any decision concerning sales of UK government bonds. If potential movements in Bank Rate were judged insufficient to achieve the inflation target, or if prevailing conditions were ones in which asset purchases might be particularly effective, the reductions in the stock of purchased assets could be amended or reversed.

59 The extent of any further tightening in monetary policy would depend on the medium-term prospects for inflation. The MPC judged that, if the economy developed broadly in line with the February *Report* central projections, some further modest tightening in monetary policy was likely to be appropriate in the coming

months. The Committee continued to judge that there were two-sided risks around the medium-term inflation outlook, primarily from wage developments on the upside and from energy and global tradable goods prices on the downside. The Committee would update its assessment on the balance of the risks to medium-term inflation in light of the relevant data as they emerged.

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

> Bank Rate should be increased by 0.25 percentage points, to 0.5%;
>
> The Bank of England should begin to reduce the stock of UK government bond purchases, financed by the issuance of central bank reserves, by ceasing to reinvest maturing assets;
>
> The Bank of England should begin to reduce the stock of sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, by ceasing to reinvest maturing assets and by a programme of asset sales to be completed no earlier than towards the end of 2023 that should unwind fully the stock of corporate bond purchases.

Five members (Andrew Bailey, Ben Broadbent, Jon Cunliffe, Huw Pill and Silvana Tenreyro) voted in favour of the first proposition. Four members (Jonathan Haskel, Catherine L Mann, Dave Ramsden and Michael Saunders) voted against this proposition, preferring to increase Bank Rate by 0.5 percentage points, to 0.75%.

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

Operational considerations

61 At its September 2021 meeting, the MPC had agreed to reinvest the cash flows associated with reductions in the stock of sterling non-financial investment-grade corporate bond purchases held by the Asset Purchase Facility (APF) back into eligible corporate bonds, commencing in November 2021. The Committee had been briefed at its February meeting on this programme of reinvestments completed in the run-up to the meeting and undertaken in line with the approach to greening set out in the Bank of England's announcement in November 2021.

62 As of 2 February 2022, the total stock of assets held in the APF was £895 billion, comprising £875 billion of UK government bond purchases and £20 billion of sterling non-financial investment-grade corporate bond purchases.

63 Consistent with the Committee’s decision at this meeting to begin to reduce the stock of UK government bond purchases, the £27.9 billion of cash flows associated with the redemption of the March 2022 gilt held by the APF would not be reinvested.

64 In total over 2022 and 2023, just over £70 billion of UK government bonds held by the APF would mature, and over 2024 and 2025 around a further £130 billion of bonds would mature. Details of the full maturity profile of APF-owned government bonds would be set out on the Bank of England’s website, which would be kept

updated to ensure that the general public and financial markets had clear information on how the size of the APF was scheduled to evolve.

65 As the stock of purchased assets began to fall, the Bank of England would continue to monitor money market functioning closely, and would stand ready to adjust reserves in either direction if judged necessary to facilitate the smooth transmission of monetary policy.

66 Consistent with the decision at this meeting to begin to reduce the stock of sterling non-financial investment-grade corporate bond purchases, the Committee asked Bank staff to design a programme of corporate bond sales, details of which would be announced within three months. The programme would be designed so as not to disrupt the functioning of the sterling investment-grade corporate bond market. Further details, including the initial schedule of operations, would be set out in a Market Notice to be published ahead of the start of sales.

67 The Governor had written a letter to the Chancellor of the Exchequer setting out some of these considerations. In addition, the letter highlighted that it was appropriate for the Government indemnity associated with the APF to reduce in size progressively, in line with the reduction in the stock of purchased assets.

68 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.

69 As permitted under the Bank of England Act 1998, as amended by the Bank of England and Financial Services Act 2016, Ron Kalifa was also present on 26 and 28 January, as an observer for the purpose of exercising oversight functions in his role as a member of the Bank’s Court of Directors.