BANK OF ENGLAND

MEETINGS OF THE MONETARY POLICY COMMITTEE
July 2015

A meeting of the Monetary Policy Committee was held on Monday 6 July 2015. The following members of the Committee were present:

Mark Carney, Governor
Ben Broadbent, Deputy Governor, Monetary Policy
Jon Cunliffe, Deputy Governor, Financial Stability
Nemat Shafik, Deputy Governor, Markets and Banking
Kristin Forbes, External Member
Andrew Haldane, Chief Economist
Ian McCafferty, External Member
David Miles, External Member
Martin Weale, External Member

Dave Ramsden was present as the Treasury representative

Dorothy Thompson was present as an observer in her role as a member of the Oversight Committee of Court

The following members of staff were present:

Gareth Ramsay, Director, Monetary Analysis
James Bell, MPC Secretariat
Chris Young, MPC Secretariat
Fergal Shortall, MPC Secretariat
Melissa Davey, Editor of the Inflation Report

Transcript of the Monetary Policy Committee Meeting on

Monday 6 July 2015

Governor Carney. Governor Carney. So welcome colleagues. Just take note that we received an update on the Greek situation prior to the formal start of this meeting. I will also note that we have advance sight, I say we but it is actually I, had advance sight of the industrial production figures and I did not bring them up with me. I do remember what they were. Go ahead Ben.

Ben Broadbent. Manufacturing was down 0.6% on the month I can't remember the totals.

Governor Carney. The total industrial production the news was 0.1% weaker because manufacturing was off as Ben says but energy was higher. So obviously some volatility in the energy sector so comes out at 1% versus our expectation of 1.1% I believe. So take it for what it's worth. OK Andy do you have anything else?

Andrew Haldane. It's been very data light since end of last week. We had some new car registrations data this morning which was modestly higher, but no great news in that. We had the Halifax House Price Index at the tail-end of last week which was quite a bit higher but taken together with the Nationwide that's broadly in line with our upwards revised house price forecast. So that's been it really.

Governor Carney. OK so let's kick off and I will start with Ben Broadbent please.

Ben Broadbent. Thank you Governor. I will begin with the main international news. As we're all aware this was dominated by events in Greece where, on 27 June, the government withdrew from negotiations with creditors and called a referendum on their latest offer. We now know the referendum resulted in a decisive "no" vote. This seems to have been celebrated in Greece as marking the end of austerity. But in the intervening week the Greek government missed the 30 June deadline for a €1.5 billion payment to the IMF, the ECB also froze its ELA lending to Greek banks and the Greek government imposed limits on cash withdrawals from banks and some capital controls.

So it's not clear to what degree this genuinely strengthens the hand of the Greek government in any renewed negotiations with creditors. And the reality of the bank run looks likely to intervene before the payment due to the European Central bank in two weeks' time, even before those negotiations can really get going. This puts the ECB in an unenviable position. It's certainly hard to see how, having capped ELA last week, it could justify raising that ceiling today. Yet without that, the economic consequences of the run - and the attraction of some alternative scrip currency within Greece - grow by the day, not to say the hour.

And even if the Greek government has been bolstered by the results of the referendum, its negotiating position will not have been strengthened by an immediate reaction in financial markets that, on the face of it, looks relatively muted. Of course, markets may continue to expect some sort of deal. The cumulative changes in asset prices over the past month, and since our May Inflation Report, are more significant, a point to which I'll return. The crisis could yet take a further toll on sentiment in Europe, both in markets and among businesses. But overnight, at least, the euro is down only half a cent against the dollar, European equity prices are down less 2%. Much milder than many feared.

At least for the time being, the proximate indicators of economic activity in the euro area are also healthy. The composite PMI rose again in June, to a level consistent with the ½% rate of GDP growth we expect for Q2. After a weak first quarter, growth also looks set to rebound in the United States. Our latest projection is for GDP to rise by 0.8% on the quarter. The US unemployment rate fell to 5.3% in June, driven both by new jobs and another decline in the participation rate. Despite that, annual pay growth dipped slightly, from 2 to 1.9%. Core inflation also fell back a bit.

It looks likely that economic growth in the second quarter will also have bounced back in this country, and the near-term data look to be coming in broadly in line with this and many other aspects of our May Inflation Report forecasts. The ONS revised upwards its estimate of GDP growth in the year to Q1 by 0.5% point, compared with a gap of 0.4% points in the backcast. The monthly activity data, official as well as surveys, look consistent with our expectation of 0.7% growth between Q1 and Q2.

And if you multiply wages by employment, the latest LFS data for aggregate nominal pay - and, therefore, holding fixed real GDP, for unit wage costs - look broadly in line with what was expected in the last Inflation Report. But there are some important details within that.

For example, the direction of the news in the latest release, for the three months to April, depends on whether or not you include bonuses. If you do - if you count those as a cost of employment - unit wage costs in the private sector look to have been 0.3% higher than implied in the last Inflation Report. Without them they were 0.3% points lower. My own view is that, because they're not a contractual obligation, bonuses should not be counted as a marginal cost of employment - not, at least, to the same extent as basic pay. But that is clearly something open to debate.

And underneath that figure for aggregate pay, the news in quantities and prices went in opposite directions. Average earnings were quite a bit stronger than we'd expected. Though much of that surprise was, as I say, in the bonus component. Total hours worked were ½% lower than forecast.

One reason for this mix might be waning compositional effects. We expected this to boost both productivity and pay, but perhaps the effect is coming through faster than predicted. If so, then the first-order impact on costs is probably small. Equally, if it becomes harder to depress frictional unemployment the closer one gets to the natural rate, perhaps the conjunction of slowing employment growth and faster pay growth might simply indicate a tightening labour market. This would be consistent with rises in the number of vacancies and in survey indicators of skill shortages, including that of our own Agents. Quite probably both are true. It will obviously be important to think through these numbers in the forthcoming forecast round.

The forecast will also have to contend with some marked moves in asset prices over the past two to three months. As I said the Greek referendum result has had less of an impact than many feared, at least in the first instance. Nevertheless sterling is 3% more expensive than at the time of the May Report; UK shares are almost 5% cheaper, equivalent to an increase of around 40 basis points on the cost of equity finance; forward interest rates - one year rates, one year forward - are up around 15 basis points. In one of these simple "financial conditions indices", these moves would accumulate and be equivalent to a reasonable rise, one to two hikes perhaps, in short term official interest rates.

These indices are not for the purists. They combine asset prices that are quintessentially endogenous and present them as having independent and unvarying effects on demand. Yet the significance of a move in the exchange rate, say, depends on why it's occurred. If markets reasonably conclude that one country's productivity looks set to outstrip that in another, the resulting appreciation in the currency is justified by fundamentals and would not slow growth. Cyclically strong domestic demand, again relative to other countries, would also push up the currency. Currencies typically appreciate during upswings and that doesn't prevent the need at some point for tighter monetary policy.

But where they can be useful, I think, financial conditions indices, is in signalling where overall financing costs have moved in an unusual fashion, up or down, given the economic data prevailing at the time. We will see what the staff work in this area comes up with. But it's not evident to me, at least, that the recent economic news in the UK has been more bullish than that in other countries. If so, then the tightening in financial conditions looks more like something exogenous - an "all else equal" assumption may be a more reasonable one - and therefore my guess is that they would tend to crimp demand growth. So we will have an interesting forecast round trading off what looks like stronger news on the domestic economy but tightening influences from elsewhere.

For the time being, I am inclined to vote for no change in policy, either Bank Rate or the stock of purchased assets. Thank you.

Governor Carney. OK Ben so Minouche then Martin please.

Nemat Shafik. So I am going to follow Kristin's footsteps and draw on the weather to motivate my comments this month. There were times in the early months of the year when we thought that summer would never come. But, coinciding with the warming of this weather, there have been some important economic developments in the data in recent months. These have brought the prospect of normalisation into sharper focus, and I would like to use my statement this morning to set out the things I will be looking at as I consider my vote over the coming quarters.

Let me begin by saying a few words about the headwinds. Credit conditions, fiscal consolidation, euro area demand, and debt overhang as they were, after all, the reasons why the equilibrium interest rate has been so low, and thus why it has been warranted to keep Bank Rate so low for so long.

So as we discussed on Thursday, the supply of credit has clearly improved, and it's probably fair to say that it is no longer a headwind but possibly a tailwind. Financial conditions are easier than at any time since the crisis, with the key point being that the recent improvement is less about the headline price of credit, and more about its increasing availability. Ben reported banks queuing round the block to lend to businesses, and the availability of unsecured credit to households has also been on the rise.

The narratives around the fiscal and euro area headwinds are actually quite similar. Both have been a drag on activity over recent years relative to normal, and I expect both to continue to be so over the coming years. It's difficult to see material upside risks to the outlook from either, and I take some comfort that the downside risks will only materialise in the events of serious mistakes by policymakers and on that front frankly I am more worried about Europe than the UK.

Of course the most obvious trigger for such a risk materialising is the Greek situation with its newly coined moniker of Grimbo, Greece in limbo, I fear Grimbo will be a source of instability for a long time to come. I think it's unavoidable and our focus has to be on building resilience, minimising contagion and assessing the impact on our largest trading partner and the consequent implications for us.

The other headwind in recent years has been the effect of the debt overhang on domestic private sector demand. And I have been encouraged by the recent data. GDP growth has been revised up, thanks largely to an upward revision to consumption, and the surveys point to continuing momentum in the coming quarters. Perhaps most significantly given the prospect of ongoing balance sheet repair by the government as Dave briefed us on earlier and our trading partners, private sector demand for credit seems to be growing too: private sector borrowing growth is running now at a healthy 3% or so which indicates that the debt overhang is no longer holding back domestic activity.

To these real headwinds, I would add the nominal headwind which is around the weakness in wage growth which has been so difficult for us to explain at times over the past year. The risk that this unexplained weakness in wages would persist was a significant concern, particularly when we had weak headline inflation caused by external factors.
But the recent data has gone a long way towards assuaging that fear. Private sector pay growth of around 3.3% is beginning to look something like normal. And while it may not be a surprise relative to our forecast, the very fact it has materialised has significantly reduced the probability that inflation will linger below target for longer.

So with all of these headwinds abating, except of course the caveat around the eurozone, the equilibrium rate is likely to be rising. And as the degree of slack in the economy closes, Bank Rate will in due course need to rise with it. Financial markets seem to be pricing the first increase in Bank Rate sometime between November and May. Conditional on no further surprises, that seems a pretty fair appraisal to me. That conditionality is quite strong given recent events in Greece. However, in the meantime I will be paying particular attention to the evolution of four variables which I think are key for decisions about the UK. First is wage growth where I think we need be reassured that we haven't plateaued at a new normal somewhat below a rate consistent with the inflation target. Second, productivity because of course it determines the rate of wage growth consistent with the inflation target. Third, the exchange rate. And fourth, headline inflation as the job of raising rates will be made easier once our forecast of a rebound has been proven to be correct.

So absent further surprises, which today feels like a rather large caveat, the question of when to raise rates then boils down to a question of monetary strategy and the benefits of going early versus going late. This is a hard question which I am sure we are going discuss at length over the coming quarters. And I hope the staff will present us with some material to help us make that judgement and the trade-offs therein.

The first key consideration will be how one sees the costs of making an error in either direction. In my opinion, an undershoot of the inflation target will be more difficult to correct than an overshoot, making it more likely that it would prove persistent. This is not the same as saying I am treating the target asymmetrically but rather than mistakes in one direction are more likely to be more difficult to correct and hence more costly.

The second key monetary strategy consideration is the strategic decision on how financial markets react to the first change in Bank Rate in six years and in particular the yield curve and the exchange rate. The message I took away from the work presented to us on previous US tightening cycles was that communication was key and that the opaque tightening around in 1994 led to large market reactions, while the better trailed moves of 1999 and 2004 were much better anticipated. And good communication will be more important this time given the particular set of circumstances in which we are likely to raise rates, with very compressed term premia, fragile market liquidity and a stock of assets on our balance sheet which will at some point need to be reduced. Equally important is using the information from market reactions to our actions to inform subsequent policy moves. As Hegel would say, this will ultimately be a dialectic process.

A third strategic consideration will be to choose a time for lift off that is consistent with being able to deliver on the gradual and limited path for Bank Rate that we have conveyed.

But those hard questions of monetary strategy lie ahead of us. For this month I am content simply to observe that the headwinds facing the economy are continuing to ease, and that the heatwave we have enjoyed has coincided with a warming of the economic data.

So this month, I intend to vote for no change in Bank Rate, and no change in the stock of purchased assets.

Governor Carney. Top that Kristin? You will get a chance as its Martin then Kristin please.

Martin Weale. OK well thank you, Governor. It is reassuring that so far market movements have been relatively limited after the Greek referendum with, at least so far, share prices recovering somewhat from opening lows. Nevertheless as your update made clear there are very real risks of major disruption throughout Europe. Could I mention two other sources of uncertainty as well. First, while the briefing on the Budget was very helpful, there may be details which are material for our view of the economy, and any of these will be clear very shortly. Secondly, there is the bear market in China. While some stock market crashes have had important and negative implications for economies, others have not. We need to monitor the situation, but so far I do not have particular concerns about the implications for UK inflation. Indeed given what we have already been told about the budget, it is only the situation in Greece which is a material source of uncertainty influencing my decision.

The PMI figures for the euro area point to a buoyant picture, but other surveys are less encouraging. Both the current and the expectations components of the Ifo indicator fell in June giving an overall decline of 1.1 points after a marginal decline in May. The INSEE business climate index of manufacturing fell in June and the European Commission industrial confidence indicators also declined in Italy and Spain. That is not to say that the PMI message is wrong, but it does make me wonder whether the situation is as buoyant as the PMI figures suggest; the differences may well depend on the dates on which the data were collected, given the volatile news about Greece even in the first half of June.

Let me like Minouche turn to monetary strategy. In May Bank staff recently drew our attention to an early draft of a paper for the Brookings conference suggesting that, in current circumstances, the optimal policy is to delay any increase in Bank Rate but then increase it relatively rapidly, in order to offset the effects of the zero lower bound. As far as I remember, Governor, you made the same point when we had a bilateral meeting about eighteen months ago.

Another way of describing this result is to suggest that the policy should be much more powerful than the traditional Taylor rule, at least when inflation is below target. With inflation well below target, that would imply that, if not constrained by a lower limit, the required Bank Rate would be below where it actually is, and that one would wait for inflation to move closer to target before making a policy change. I have looked at a model with a serially-correlated stochastic headwind and a lower bound to the Bank Rate. With reasonable assumptions about the expected rate of decay of the headwind, the results confirm the desirability of a powerful Taylor rule, at least when the economy is weak. That gives results similar to the optimal policy in a New Keynesian framework.

The difficulty I have with this is, however, is that a powerful Taylor rule is inconsistent with gradualism. But I think the argument for gradualism is as valid today as it was early last year. If I reject abruptism in favour of gradualism, then I am also, as far as I can see, rejecting the argument that we should keep the Bank Rate particularly low because of the risks associated with the zero lower bound.

Of course what comes out of a traditional Taylor rule depends how you see it. If I take the view that the recent decline in participation is largely the result of living standards and thus reduced supply of some types of labour, a point I owe to Ian, rather than as an indicator of more spare capacity in the labour market, then it is reasonable to take as a median view, that spare capacity is probably now more or less exhausted. If I were to define a standard Taylor rule in terms of core inflation, that would point to setting Bank Rate say just over 1½ points below r*, which takes us back to the question of what r* is at present, and could, on its own terms, make a case for an immediate tightening. I do not have anything to add on the issue of r* to the comments you and David made in June.

Another way of looking at this is with reference to our May forecast. That showed inflation rising above target two years out, and, as I said in May, my own view was that, given the profile for Bank Rate, inflation would continue to rise in year three. Since then we have had downside news for inflation from the rise in the exchange rate, and the revision to productivity, and some upside news from the movement in wages. It is perfectly possible that even the level effect of higher wages may not persist; the April figures may just be erratic and it is almost always a mistake to respond to one month's possibly erratic data. But if the higher level of wages does persist, as the staff have assumed, then presumably, supply chain lags mean that the shock to wages will affect inflation at the two year horizon.

Based on the national accounts measures of wages, staff suggest that the productivity improvement more or less offsets higher wages, leaving the exchange rate rise affecting inflation in two years and further out. I understood Bank staff to say that AWE may be a better guide to near term pay movement than figures in the national accounts and, given that, I wonder whether the combined effect of wages and productivity on inflation is really neutral. AWE suggests that underlying wage costs are probably about 2% higher than a year ago; the current rate of growth of private sector regular pay is, however, probably higher than the increase over the last year. As we know the three-month on three-month rate is erratic, but it is nevertheless buoyant. Without a further improvement in productivity, it seems that wage costs may already be rising faster than is consistent with our target. Exchange rate effects also matter but my sense is that we would need a further appreciation to offset the effects of continuing tightening of the labour market.

Of course it is also the case that the yield curve is now higher than it was at the time of the May Inflation Report, with the rate in 2016 Q3 up by 0.12 percentage points and in 2017 Q3 up by 0.29 percentage points. How far the anticipation of these spot rates affects demand over the next year or so is, like everything else a matter of judgement but I doubt that these changes would on their own have a material effect on the pressures arising from the labour market.

Given the uncertainty arising from the situation in Greece, I think that despite labour market developments it would be wrong to tighten policy at present, although in its absence I would see a stronger case for an increase in Bank Rate than in June. As it is, my decision is to vote to keep Bank Rate at ½ per cent and for no change of the stock of assets.

Governor Carney. Thank you. Just for the record I don't recall this conversation we had eighteen months ago about suggesting delay [in raising Bank Rate][1] and [inflation] overshoots. I will make that absolutely clear and I don't think I have ever advocated that in any of our policy meetings.

Governor Carney. Kristin and then David.

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[1] MPC Secretariat clarification.

Kristin Forbes. This month there was a substantial amount of economic news. Key data releases suggested that the UK recovery is not only solid, but may have been stronger than our baseline. Implications for monetary policy, however, are complicated by risks related to Greece. My comments will cover what I see as the sunshine over the UK and the growing shadow of Greece.

Governor Carney. Good.

Kristin Forbes. Back revisions to real GDP growth indicate that previous momentum was even stronger than estimated; annual GDP growth (through Q1) was revised to 2.9% (up 0.2%[2] from the May IR) with additional upward revision likely. Q1 consumption growth was revised upward (0.2 percentage points stronger on a quarterly basis than predicted in the May IR). Consumers are spending their dividend from lower oil prices. Business and housing investment growth were also revised upwards (1.2 percentage points and 3.4 percentage points, respectively, than in the May IR). Even government spending and net trade dragged slightly less than in the May IR. The main downside surprise through Q1 was in the other category mainly indicating less stockbuilding and therefore potential future upside.

Foundations for continued solid growth are in place. Consumption should continue to be supported by lower oil prices, stronger real wage growth, and positive consumer confidence. Albeit hopefully less by reduced saving. Relatively easy lending conditions and momentum in profits and demand should continue to support business investment. Recent news on house prices and mortgage approvals indicates momentum and upside potential in housing. The preliminary information we received about the forthcoming budget reduces the risk that the government sector will create additional drags on growth than currently built in.

Net exports are the greatest risk primarily from developments in Greece and effects on the euro area. Any drag on UK exports, however, could be partially counteracted by solid demand in the US. Recent US data has confirmed that the Q1 slowdown was temporary and Q2 growth should be above trend.

The other main risk to global demand, which has recently been overshadowed by events in Greece, is China. Predicting growth in China is always challenging but the current range is noteworthy. Not only has the swathe of forecasts widened sharply but at Pre-MPC we saw that current estimates range from quarterly growth of about 0 to 3%. Not terribly precise.

Shifting from demand to prices, other positive news this month was that near-zero inflation does not show signs of weighing significantly on wage growth. Whole economy AWE regular and total pay growth surprised on the upside at 2.7% in the three months to April. Granted, much of the surprise was in bonuses, some of the surprise may reflect an unwinding of composition effects, and this series is volatile so I would not be surprised if next month does not show a similar improvement. But this confirms that the recent upward movement in wage growth is a trend, not a blip, and has not been derailed by near zero inflation. It is noteworthy that after adjusting for inflation, real wage growth is higher than its pre-crisis average when productivity growth was also stronger.

This series of upside surprises suggests that inflation could pick up faster than our previous baseline. I am also less worried about the risk of additional drags from low inflation in neighbouring countries. In work for a recent speech, I tried to find any significant effects on UK inflation from inflation in other countries with which the UK might have strong ties (outside of the usual controls). Even after an extensive amount of data mining, however, I was unable to find substantive evidence of any additional effects from inflation in key partners. This work also showed that a simple model could explain the recent sharp fall in UK inflation through movements in sterling, energy, and other world export prices. There was no evidence of unusual factors derailing the normal inflation generating process in the UK today.

While this empirical exercise and recent positive data surprises would all suggest that the date when Bank Rate should be raised has moved forward, there are a few new factors that partially counteract this. Stronger economic data has contributed to a slight tightening of short-term interest rates, a ticking up in bank wholesale funding costs, and additional sterling appreciation (about 3% since the May IR). This could tighten financial conditions and reduce net exports.

[2] MPC Secretariat clarification: up 0.2 percentage points from the May IR.

Even more important for monetary policy is the pickup in productivity growth (to 0.8% annually in Q1, above the 0.3% forecast). This is unambiguously good news. It may reflect firms improving productivity in response to a tighter labour market and therefore continue. Stronger productivity growth would provide more time before needing to raise rates. I just wish that I better understood recent productivity growth in order to be more confident predicting what comes next.

Finally, to the shadow of Greece. Whatever happens will be extremely difficult for people living in Greece. But direct channels of contagion (such as through trade, banks, and investors' forced portfolio recompositions) should be manageable. The crisis has been building for some time, reducing the surprise factor that often drives contagion. There are additional tools to respond if needed. For all these reasons, whatever happens next should have small direct economic effects on the UK.

But some aspects of contagion are impossible to predict. There are often channels and vulnerabilities that no one foresees. There could be a sharp increase in risk aversion or market reaction that generates other problems that bear no obvious direct relationship to Greece. This particularly concerns me today given the vulnerabilities from China and recent changes in market liquidity. Even if there is no sharp market reaction, greater uncertainty about the structure of the eurozone could weigh on the entire region especially periphery countries. This could undermine the nascent recovery.

This risk has been apparent in markets. Correlations between Greek equity and debt markets and those in more vulnerable euro countries, namely Portugal, Spain and Italy, have recently increased. These correlations are still about half those from other phases of the euro crisis, and correlations have not significantly increased between Greece and other core euro countries or non-euro countries. This suggests contagion to date has been small and the risks today are less than in the past. But the recent increase in spreads on Spanish, Italian and Portuguese debt, and the moderate increased co-movement between Greece and other peripherals is a warning. Despite the ECB's asset purchases, periphery countries and the Balkans are not completely immune to events in Greece.

What does all this mean for monetary policy? If it were not for the shadow from Greece, the positive UK data this month would lead me to conclude that the decision today on whether to raise interest rates or not was finely balanced. But given the risks around Greece, this is not the time to change monetary policy. Inflation should remain near zero for a few months, and even if it picks up faster than currently forecast, there is little chance of it picking up so quickly that it exceeds target in the next year. Therefore, there is little risk to waiting a bit longer to see how events in Greece play out and affect the UK.

But, that window is small given the minimal (if any) slack left in the economy, gradually strengthening unit labour costs, strong domestic demand, and soon fading effects of lower energy and food prices. As Leo Tolstoy said, "Even in the valley of the shadow of death, two and two do not make six." Given how long challenges in Greece are likely to persist, unfortunately we will not have the luxury of waiting until all Greece-related uncertainty is resolved before needing to tighten monetary policy.

Governor Carney. Two and two do not make six, did he say that?

Kristin Forbes. At least according to Wikipedia.

Governor Carney. Right well I was going to say you might want to check.

Ben Broadbent. Hegel and Tolstoy…[indecipherable]

Nemat Shafik. Whoever said the MPC was…[indecipherable]

Governor Carney. David and then Ian please.

David Miles. If we are to make communications in our minutes very cryptic then I think we should have the Tolstoy and Hegel; definitely Hegel who's always cryptic. Sometimes, I try the following thought experiment which is probably a bit inconsistent but let me share it with you. It's a thought experiment to see whether monetary policy might be in the right ball park. I try to imagine that, you could see all the economic signals we have in front of us - output, inflation, consumer confidence, cost and availability of credit, business sentiment, expectations, wages, expected inflation and all that - but you couldn't, you didn't know where monetary policy had been in the UK at least for the last six months. Maybe you could see where it had been before that. And then you ask yourself the question, given all the economic indicators, where do you think policy should have been over the previous few months and where should it be going for the next several months? I must say recently when I have been trying this rather bizarre thought experiment I have found it pretty hard, just focussing on domestic indicators, to come up with a stance of policy that has Bank Rate at ½% over the last few months and the market expectation that it stays at this level into next year. Now of course the range of indicators I have just mentioned, they are all domestic, and I think if you just look at domestic indicators to me now they are at a level that suggests we should really be beginning to gradually normalise policy - which is an euphemism for raising Bank Rate.

So why aren't we doing that? Let me start with what I think is the least good answer to that question. I think the least good answer is: because inflation is near zero. And I think that is not a very good answer because it focusses, self-evidently, on where inflation is today rather than where it might be 12 to 24 months down the road. And actually one of the things I think we understand relatively well, and there are lots of things we don't understand well, is the current level of inflation I put in the category as something we do understand pretty well. And of course to a large extent, as we all know, it's because we have had some rather benign commodity price movements over the last year or so and what's now a pretty significant rise in sterling - I think we are up about 10% on where we were eighteen months ago. Our central guess is that these factors are likely to prove transitory, or rather than their impact on inflation will prove transitory, and that seems to me a good guess actually as to the most likely outcome. That is why I think it is sensible to continue to think the most likely path for inflation is it begins to pick up quite sharply towards the end of this year as you go into next year.

Just as we did not let inflation - which in late 2011 got to over 5% - we didn't let that inflation rate at that time dictate that a tighter monetary policy had to be right then, we clearly shouldn't I don't think see very low current inflation as a decisive argument for maintaining unchanged a very expansionary monetary policy.

So that's a not very good answer it seems to me as to why we should stick with where we are. So what is it that makes a continuation of unchanged policy potentially the right answer? I think like others that it is really to do with the international situation rather than the signals we are getting from within the UK and I think without those signs of a relatively weak and slightly softening international economy, I think without that we really would be in danger of keeping policy too loose too long. Too long to be consistent with what I think is the very sensible aim, as Martin said, of seeking a very gradual path of Bank Rate back toward a more normal and sustainable level.

And I say all that despite believing we have tended to underestimate, I think, the degree of slack in the economy. Our current estimate, around about ½% (I think it was in May our current estimate) may well still actually be on the low side - I think it probably is. But I am also sceptical about whether the degree of slack, even if it is 1% or even 2%, actually is doing a whole lot on inflation pressures. And right now I think I am rather more swayed by the signs of steady growth in the economy, low cost of funds to the private sector, rising wages, warmer housing market and a low household low saving rate. As I said, if you just looked at those things I think you have to ask some pretty serious questions whether Bank Rate at 0.5% is now appropriate.

But like others what makes me hesitate really before advocating what you might call a small start on the gradual - hopefully gradual - path towards normalisation, what makes me hesitate is looking at overseas demand plus the enormous uncertainty right now about how the Greek situation plays out. So given that backdrop, and the rather unwelcome rise in sterling over the past year or so, and given the very large current account deficit a normalisation in policy right now at this meeting which clearly would be unexpected and would come before the US has started down that road does risk taking sterling higher. That's a risk. It's by no means a certainty. And actually it will always be a risk, I think, at the point which we do begin on the road back towards a more normal monetary policy. But today for me it's enough to suggest that holding policy where it is is the right strategy right now. But as I say in reaching that view I do find I am now attaching a good deal of weight to the unusual and very worrying situation in Europe and just the extremely unclear implications of the vote that we have just seen from Greece.

And absent that situation I now think that the case for starting what you might call a gradual amble back toward a more normal monetary policy - the choice between now or waiting a bit longer is actually pretty finely balanced now.

I think one factor to my mind that we shouldn't give a lot of weight to in delaying this process of starting normalisation, and that's the risk of deflationary expectations driving the economy toward a very low growth trap from which we then have very few monetary policy tools to rely on to get out of. It strikes me that once again despite very low inflation (another month of very low inflation) we have very few signs of widespread expectations of continuing zero or negative inflation. There is little sign I would say that current low inflation is a significant drag on wages. The latest data we have seen is fairly strong, albeit you have to include bonuses in it to get to that conclusion. I don't think there is any sign that low inflation is holding back consumer spending. Consumer confidence has risen now back to pre-crisis levels; the consumer savings rate has been on a downward trajectory for a few months it's now under 5%. That just doesn't look to me like a situation where fear of deflation is about to overwhelm confidence and drag spending lower.

But for now I am very likely on Wednesday to vote for no change in policy. But it is becoming a much closer decision. I think the August Inflation Report is a good opportunity to do, in a more formal way, my sort of blank piece of paper thinking about whether we still have the right setting for policy.

Governor Carney. OK so that's no change, no change.

David Miles. Yes.

Governor Carney. Thank you. Ian and then Jon please.

Ian McCafferty. Thank you Governor, and good morning and I hope that the new microphones make up for my lack of voice.

Yesterday's referendum result provides a sobering start to the week. The optimist in me still hopes that a "no" vote may not be the end of the road, but time is running short, continued ECB financing will be critical, and there are no obvious political routes through this particular mire.

It is clearly far too early to assess with any clarity the possible impact of the weekend's events on the UK. Reaction in financial markets this morning has so far been limited, but this feels a little like a phony calm, and the bigger potential impact - via business confidence and underlying eurozone activity - will take longer to assess. I think this will be a difficult call when we come to some of the background thinking behind our August forecast. Up to the end of last week, the evidence on business sentiment in the eurozone had been equivocal. The Markit composite eurozone survey continued to strengthen in June, but a number of domestic national surveys, including Ifo and INSEE, suggested that confidence had been hit, even though the impact on activity was rather less marked.

But while Greece has dominated the front pages this month, this should not completely eclipse the rest of the news, much of which has been of some import.

On the international front, the news outside Europe tended to support our previous judgements, of worrying weakness in China and a strengthening US economy.

In China, I find it hard to assess how far the stock market gyrations will affect the broader economy, and to what extent they can be suppressed by the authorities, but the exposure of unsophisticated retail investors to margin buying does look very worrying.

In the US, the data provide further confirmation that the Q1 slowdown was a little quirky. Solid payroll data should clear the way for the Fed to begin the road to normalisation over the second half, though I find it slightly worrying that the expectations contained in the Fed dotplot and those given by the markets still remain so far apart even at short horizons, leaving scope for material volatility in coming months.

But, for me, other than in Greece (and apart from that, Mrs Lincoln, how did you enjoy the play?), much of the most important news was about the UK, and here, the data suggest some nuanced but important shifts in the narrative contained in the May Inflation Report.

First, the narrative that the economy stepped down a gear in the second half of last year is now much more open to question. It is not only the upward revision to GDP itself, but the pattern of persistent strength in the key domestic demand components that suggests that underlying momentum remains strong. This repeats the pattern of 2013/14, in which the initial data supported the idea that above trend activity would be driven temporarily by improving confidence and easing headwinds, only to settle back to a more moderate pace. And of course this was later dashed by data revisions indicating more persistent strength.

While it is impossible to be conclusive at this juncture, the recent performance of the economy strengthens the hypothesis that r* is now back to positive territory, and that the current monetary stance has been providing material stimulus to demand. As a result, I am now less confident in the IR forecast of growth slowing naturally to in line or just below trend in coming quarters, unless that of course was driven by the fallout from the eurozone.

The second point I think is that the employment data do test our narrative around the level and pace of absorption of slack. Contrary to the recent Costs and Prices monthly note, which interprets this month's news on participation, hours and employment as a mechanical increase in the level of slack, the data suggest to me that the level of effective slack is now close to zero, with the slowing in the rate of employment growth due to frictional difficulties in rehiring the long term unemployed, while the weaker hours and participation data may well reflect stronger income growth and a substitution effect of work for leisure. Declining slack is also more consistent with the pick-up in wage growth seen in recent months, and I would strongly resist incorporating yet more slack into our August forecast.

Third, the upside risks to the pace of acceleration in wages look to have increased. This may, as suggested at Pre-MPC, simply represent an earlier trajectory to our previously expected pace of unit wage cost growth, but also challenges our narrative of a slow absorption of remaining slack combined with a relatively flat Phillips curve. As such, I think it reinforces the upside risks I have previously talked about in terms of the possible degree of overshoot to CPI inflation at the far end of our forecast.

The main reason that inflation is not already higher than 2.1% at the end of the forecast horizon appears to me the estimated dampening effect of recent sterling appreciation. Now in my view, the degree of pass-through of import price inflation is hugely uncertain, making it a soft pillar on which to build a hard inflation forecast. In May, it was a close call for me between accepting the IR forecast and pushing for a higher inflation endpoint, and I think we will need to look at this in our August forecast.

And the fourth point is, the latest data also suggests much of the downside risk of low inflation persistence in our early year narrative has now evaporated. It was this risk that caused me to shift my vote in January. According to the STIF, there are still several more months of near zero inflation to go, but the continued strength of consumer confidence, the stability of inflation expectations and evidence that wage settlements are not being depressed by the existence of low inflation all suggest that while it represented a high impact risk, it was, after all, of low probability, and the likelihood of behavioural change driving persistent low inflation from here is receding rapidly.

Finally and fifthly, we learned from Dave Ramsden that the forthcoming Budget will reveal a path for fiscal consolidation with slightly less fiscal drag over our forecast horizon than previously assumed. With consumers buoyant and credit conditions normalising, fiscal consolidation is the one remaining domestic headwind influencing the forecast, and may now be slightly less dominant than previously judged.

Together, these factors lead me to expect that, unless the impact from Greece is marked, inflation is likely to return to target a little earlier than the timing in the May forecast, and that the overshoot thereafter could be also slightly more marked. Moreover, the balance of risks around that central trajectory – again absent Greece – is also shifting. The near-term downside risk of persistent low inflation has all but disappeared, whereas the long term upside domestic inflation risks appear to have edged up.

And while monetary conditions have tightened slightly in recent months, particularly through the continued appreciation of sterling, yields are only back to where they were late last year, such that the market, in my view, is not doing all of the monetary policy work for us.

As such, in the absence of the uncertainty around Greece, the argument in favour of a change in Bank Rate would be more compelling this month than last. But it is clearly far too early to make any judgement on either the scale or the duration of the impact of the Greek crisis on the UK, and as such, this month I intend to vote for no change in either Bank rate or the level of asset purchases.

Governor Carney. Thank you Ian. So Jon and then Andy please.

Jon Cunliffe. This is clearly the meeting for meteorological metaphors so I think I will be start by saying there's a very bad storm in the Eastern Mediterranean and the issue for me is how far it's going to move and affect the weather elsewhere and the speed at which developments in Greece have moved and the severity of the movement I think just underline that concern.

With yesterday's referendum vote the probability for me must now be a Greek exit or effective exit from the euro and probably in a disorderly fashion. The possibility of contagion to other euro periphery members has increased and with it the possibility of a crystallisation of tail risks that could have a chilling effect on the UK economy though small has got larger.

There are some reasons to be more confident than in 2012 that these tail risks will not crystallise. The euro area has more and more powerful policy instruments available to preserve the integrity and the stability of the single currency. The euro-area economy including periphery countries is stronger; though like others I note that there are some signs in some of the forward-looking indicators that may be softening. The ECB has commenced a major sovereign bond purchase programme which could be front loaded and OMTs are available and the market reaction as far as the peripheral euro countries is concerned has been relatively muted. But while there are reasons to be more confident we should not discount the risks that a disorderly exit from the euro will cause contagion within the euro area and more broadly. Both in terms of the direct stress on sovereign bond yields that we saw in 2012 and also more indirectly through sentiment and confidence in the euro area.

The other downside risks on the international front is China. For 2015 as a whole, the staff expect growth to be 6.8%, consistent with the authorities' target of around 7%. That's already a significant step down from 2014. However, in the two weeks before our briefing meeting, Chinese equities fell by 20% and have fallen another 8% between that meeting and today. This may just be a correction but it looks as if it may also be part of a more sustained and deeper bear market. The Chinese authorities have responded with a battery of policy interventions over recent months including some last Friday. But the signs are growing that it is becoming increasing difficult for them to manage the slowdown in the economy, the rising currency and serious financial stability risks at the same time. So in addition to the extreme uncertainly around Greece the near term outlook in China to me also poses a downside risk to UK growth.

In contrast the news on the domestic economy has been generally positive. The GfK consumer confidence measure rebounded in June returning to historically high levels, although those surveys predated the latest developments in Greece. Surveys of output and investment intentions remain strong.

The housing market appears to be coming back to life after a slightly sleepy 2014. The RICS survey points to a pickup in house price growth; mortgage approvals in April and May were cumulatively 9,000 higher than in our May forecast. It is true that approvals in May at 64,000 were lower than the 68,000 in April but this is probably the effect of the election. Overall prices and transactions seemed to be strengthening against a background of easier credit conditions. Housing investment was also stronger than expected in Q1.

GDP growth in Q1 was revised up by 0.1%[3] to 0.4%. The near-term outlook is little changed; staff expect solid growth of 0.7% in Q2 and Q3. So overall the downside risk that the slowdown in Q1 signalled the start of something more sustained seems to have subsided. It is worth noting that the revisions to the national accounts data included a large upward revision to consumption which is now estimated to have grown by 0.9% in Q1. So consumers do seem to have been spending the windfall from lower energy prices.

One slight note of caution is the fall in the savings ratio in the first quarter to 4.9%, the lowest since the third quarter of 2008 and almost a percentage point lower than we were expecting. Using the AWE measure of pay growth, instead of wages and salaries, would imply a relatively flat saving ratio over the past year[4] and the ONS have suggested placing more weight on the AWE measure at the moment but this is something I think we do need to resolve for the future.

Pay, productivity and employment continued for me to be the key factors determining the evolution of inflation prospects in the economy. There was also positive news in pay growth. Whole economy total pay was 2.7% compared with our expectation of 2% though mainly driven by bonuses. Whole economy regular pay was 0.1%[5] higher than expected at 2.7% and private regular pay was 3.2% with the staff now forecasting private sector regular pay at 3.4% in Q1 and 3.5% in Q3.

I am still a little cautious about the pay numbers. Bonuses can be erratic. And it may also be the case that compositional effects are wearing off more quickly than we had expected. And of course what matters for inflation is wages relative to productivity as captured by unit labour costs. There is good news on the productivity side with growth at 0.8% in the year to Q1, which is ½% stronger than we had forecast in May and that impact has been seen in unit labour cost growth which despite strengthening pay remains subdued at 0.6% in the year to Q1 and which is weaker than our forecast of 1.8% in the May Inflation Report. And I note Ben's point that using AWE excluding bonuses, which can be erratic, unit wage costs are 0.3% weaker than we expected. Our forecast needs strong sustained pick up in unit labour costs to return inflation to target, particularly because import prices are likely to drag down on inflation throughout the forecast period. And on that front, I would also note the recent increase in sterling's value. Sterling has appreciated by around 3% since the June MPC meeting. I would expect the developments in Greece in the near term at least to put further upward pressure on sterling.

Finally, the downside risk to inflation expectations from very low inflation do not appear to have materialised. It is true the Barclays measures of household expectations are now quite low. But other measures indicate inflation expectations are still broadly consistent with inflation returning to target. So the downside risk to inflation in my mind seems to be passing.

Overall, while there have been positive domestic developments which are broadly in line with our forecast, I see no reason to change my vote at present. Moreover, there is now greater risk in the international developments, particularly around Greece which would in any event make a change inappropriate in my view. So my provisional vote for this meeting is no change for Bank Rate and no change in the amount of assets purchased.

Governor Carney. Thank you very much. Andy.

Andrew Haldane. Thank you. For the past few years, the backdrop has been reasonably solid, if sub-par, global growth. World trade volumes have mirrored that trend, growing on average by around 3.5% since the crisis, compared with 7.5% in the pre-crisis period. Both would almost

[3] MPC Secretariat clarification: revised up by 0.1 percentage points.
[4] MPC Secretariat clarification: subsequent to the meeting, staff highlighted that an error had been made in their calculation of this estimate. In the corrected series, the adjusted saving ratio was estimated to have fallen to 4.9% in 2015 Q1, in line with the official estimate.
[5] MPC Secretariat clarification: 0.1 percentage points higher than expected.

certainly have been weaker still were it not for the strong performance since the crisis of China, the rest of Asia and a number of emerging markets. They have contributed 80% of world growth since 2009. They have filled the global growth gap left by advanced Western economies.

Indeed, one interpretation of post-crisis growth dynamics is that deflation of the credit bubble in the West has been counter-balanced by reflation of a credit bubble in the East – and in China specifically – without which world growth would have been flatter. Regional patterns of growth and credit since the crisis are broadly consistent with that hypothesis. For example, credit in China, both bank and shadow bank, has risen by over 180% since 2010. This China reflation has, I suspect, had a larger positive impact on global growth than our standard macro ready-reckoners would imply, due to the multiplier effects of China being the world's largest commodity importer, its pivotal role in global supply chains and its growing impact on global business and risk sentiment. And as on the way up, I think we may now be seeing evidence of the potency of these global channels in reverse as China slows. This has shown up not just in a slowing across Asia, but in weakness across Latin America and indeed in parts of Europe, such as Germany.

Since the previous MPC meeting, I have spent some time in China trying to understand its slowdown and its likely longevity. Two points struck me from that. First, it is true that China lacks neither the monetary nor fiscal space to reflate, and nor does it lack the willingness to do so, as evidenced by its recent spate of loosening measures. But these only take you so far.

The stumbling block appears to be implementation. In so vast a country, implementation rests primarily at the provincial, state or city level. And here, the anti-corruption purge has sapped the risk appetite of provincial and city officials. At a time when vigorous change is needed, to transition China from being a company-led to being a consumer-led economy, they are lying low. These officials' jobs have been further complicated by the move away from singular targets for GDP growth towards multiple targets. As a result, planning blight has set in, retarding activity. Given its origins, it is hard to see that blight disappearing quickly.

Second, as the economy has slowed more rapidly than expected, there has been a conscious attempt to inflate new bubbles in an attempt to encourage consumers and cushion companies. The most recent of these bubbles as some of us have already mentioned has been in the equity market which rather remarkably has risen 150% between January of last year and January of this, largely led by retail investors. This asset price inflation has had a temporarily flattering effect on the balance sheet of retail investors, whose wealth has been boosted, and state-owned enterprises who have been able to raise cheap equity. But as events of the past few weeks have shown, with equities falling more than 20%, this boost may be short-lived. And if that equity bubble were to go significantly into reverse, its impact on the balance sheets of consumers and enterprises could provide a further headwind to growth.

And for both of those reasons, I came away thinking the risks to Chinese growth over the next year or so are squarely skewed to the downside. That could have significant implications I think for global growth, with many regions directly or indirectly reliant on China, or in the case of the euro area and the US not yet ready to fill that global growth gap if China were to leave the scene. It might seem strange to have focussed my comments on China's fortunes at a time when Greece is the word. But as China grows a new economy the size of Greece between Inflation Reports, I suspect it may be an even more important bellwether of global macro-economic events in the period ahead.

Turning to the UK, the overall demand and output picture is not greatly different than the May Inflation Report. The National Accounts revisions went some way towards reconciling differences between the survey and official data, for example on household spending, business investment and construction. And the surveys, while flattening a touch, remain consistent with some growth recovery into Q2 after a weaker Q1. Nonetheless, it's noteworthy this growth turnaround will require some – yet to be seen in the data – pick-up in services. Which is why staff put the balance of growth risks in Q2 to the downside, as would I.

On the inflation and cost front, the two key factors over the past month have clearly been wages on the one hand and the exchange rate on the other. On wages, we have now had two, maybe three, months of modestly sized upside surprises to regular pay growth, which I think is probably the better yardstick of inflation prospects. This rise was encouraging. Encouraging because we needed wage growth to pick up to hit our inflation target. And encouraging too because these upside surprises come after a string of downside surprises which had generated a wage puzzle. I think there remains something of a puzzle in the level of wages, although it is smaller than it was. And I think risks to wages remain somewhat skewed to the downside, if less so than at the start of the year. One reason I say that is because of the pattern of wage settlements which are free from distortions to bonuses and compositional effects. They point to wage growth in the 2 point something zone.

For what it is worth, my conversations with companies during the three Agency visits I have undertaken since the last MPC meeting were consistent with steady-as-she-goes wage growth in the mid-2s, outside of certain sectors.

A second factor is that, with productivity appearing to have picked up at least as much as underlying wages, it is unclear the rise in wages we have seen so far necessarily carries any implications for inflationary pressures. Unit Wage Cost growth as others have said, however flaky our estimates, still appear to be well below the inflation target. So for now I am relatively relaxed about wage developments as being no more, and more likely less, than will be required to get inflation back to target.

On the exchange rate, we have now seen a 19% appreciation in sterling from its low point in 2013 and a further 3% since the May IR. On standard ready-reckoners, the depressing effect of this on the two-year ahead inflation forecast is likely to have been at least as great as the upside news from wages.

I have a concern that financial markets have focussed on the wage news, but not on the exchange rate news to anything like the same extent. Indeed, I think the resulting rise in the yield curve has probably contributed to sterling's appreciation, with movements in relative interest rates appearing to help explain some of sterling's strength over the past few weeks. Having studied this closely since the last meeting, I am no longer either puzzled or worried by the seemingly low level of the yield curve. I think it is a reasonable reflection of the risks the UK faces.

So with inflation still rock bottom, and the economy still recovering, I am concerned about any "talking up" of the yield curve and the exchange rate. And I think that could complicate further the MPC's task of returning inflation to target in two years' time and in some respects has already done so. My view remains that the balance of inflation risks remains somewhat skewed to the downside, with inflation likely to be lower for longer than our currently published forecast. This is similar to where consumers, companies, the OBR and a number of private sector forecasts are now positioned at the two-year ahead inflation horizon.

Against that backdrop, I am minded today to leave unchanged both Bank Rate and the stock of asset purchases. Thank you.

Governor Carney. Thank you Andy. I think it is going to be hard to talk if Greece is the word slid in there a little, although the weather analogues were very good. Look my bottom line I think it would be heroic to raise rates this week in the face of Greek and European uncertainty. And while I entirely agree with David's hierarchy also with the prospect of three more low-flation letters on the horizon. Monetary policy is forward looking but it might suggest a hubristic faith in our forecasting abilities to do so at this juncture. That's the end of my attempts at poetry. My Adam Posen poetry prizes, someone else is going to get it. OK so let me, I just want to touch briefly on, I have talked about some of, at least from my perspective the necessary conditions for normalisation in monetary policy, sustained momentum in activity, to continue to ring out some of the remaining slack in the economy. Secondly a further firming in domestic cost pressures and thirdly signs that core inflation is moving towards rates consistent with target as part of a broader trend in the Fed's words that gives a reasonable expectation of total CPI inflation returning to 2% within the next two years, that being our stated objective. In terms of momentum I would say on track on the margin and I take Ian's cautions on this but on the margins I would say a bit more slack. The outlook remains solid, CIPS ticking up and remaining above average. The BCC is above average, consumer confidence has bounced back to decade highs. Welcome revisions to the quarterly growth rates and I would say on balance I would take a mild disappointment from the labour market report whether it is unemployment, average hours or participation all slightly shaded relative to our May expectations. I lean, one man's tightening labour market is another's first sawing of the dogleg coming into play, and I took it a bit of an indication on that line so I am not particularly troubled by it. Overall Grexit and China aside, the outlook is filling in as expected. Real incomes are rising. My take on the Budget is that fiscal drag is no worse over the forecast horizon. We will look closely at what actually comes out, but I think when you think about the multipliers, given the components, even though the headline deficit, there is a filling in of what was an extreme gap. It's still material fiscal drag but it is no worse. I didn't take that it was lower, although we will look more closely. On the margin, financial conditions tighter, although I think Minouche summarised it well in terms of overall availability and if one looks at a longer horizon it's a good news story.

In terms of domestic costs I would go against the grain and take domestic costs as actually being a little lower, and I am going to spend some time on that. Obviously the upside news in the whole economy total pay containing a large bonus component, I think I join Ben in being minded to think of bonuses as ex-post state contingent payments out of profits that are unlikely to be big drivers of firm's pricing decisions. Now that may not be the case, it may be empirically not the case here. I haven't seen any evidence to the contrary and I am sure staff will probably spend some time on looking at the question of whether adjusting for bonuses helps explain some of the discrepancy between the robustness of wage and price Phillips Curves here. The firming of private sector regular pay in April is obviously welcome, it's also necessary. Like others I would like to dig into the compositional facts once we have the data. Obviously we only get it quarterly to see if that is part of the explanation or it is a broader firming. Let's take it as a broader firming. Obviously we need to look at it relative to productivity. I think that virtually everyone has noted productivity is 0.5% higher in the first quarter than we had previously thought. So that implies that domestic cost growth if you match the quarter with the March outturn for private sector regular pay, domestic cost growth of 2% which is slightly less than we had expected in May. Slightly less than we had expected in May. I would take the whole thing as a wash. I very strongly join others, though, in noting that there is no evidence of this deflationary wage expectations effect and, as time goes on, take real comfort there. I think we should all give ourselves a pat on the back for outstanding communications that clearly in their absence this downside risk would have materialised.

Turning to the second issue, core CPI and external costs. Measures of core inflation have ticked up. I note that the ONS measuring the medians around 0.8 and 0.9 is one outlier in our various CPI suites. I am surprised that we don't estimate a common component, it's not that hard to do, and would suggest that we should do that, just so that we have a better trend, and I would like to see more work done on the relationship between core and core in total, core predictive power, core in total. I think we have been a bit remiss on that. As others have noted we did see a bit of a pop in sterling, at 3% since May, which would knock another 2 percentage points off annual inflation at year two on standard multipliers. We will have to really drill down on this. 0.2 percentage points, sorry. Even our pass-through [assumption][6] doesn't get to that! I would suggest, if I may add some words here since this is for strategy, looking at various cohorts of exchange rate moves, deciding what is persistent and then thinking through what we are collectively comfortable having as passed through as opposed to the incremental, mechanical adjustments would be a good way to try to get to best collective judgement in the August forecast round, because this can all add up.

6 MPC Secretariat clarification.

I would spend a moment though on sterling risk. I think we are in a world of event risk, and we are a safe haven, and we are in a world of crowded central bank trades. And that risk, as Andy intimated, depends in part on our policy response. Exchange rates aren't givens: they depend on a range of real, nominal and expectational factors. All else equal I would expect a path for Bank Rate that lifted off sooner and went steeper to add momentum to sterling's appreciation. I underscore that UIP holds only in classrooms and DSGE models, and as Kristin knows better than anyone else. Virtually anywhere else, nowhere else rather, and providing an extra channel through which monetary tightening could happen, will reduce cost pressures to the extent possible I think with everyone else I prefer to take more of our eventual monetary tightening in interest rates space than in exchange rate space. The Riksbank today shows where we don't want to be tomorrow, and so again it's difficult but I would not want to tighten multiple times for the same policy move if we can avoid it.

So bringing together domestic costs and the exchange rate I will just remind what type of cost growth we should be aiming at in the medium term to return inflation to target. Clearly 2% for 2% target but it depends on how you look at various cost components. If you look up to the crisis, import prices grew at about 1% and within the CPI basket it's about 0.4 percentage points. That equates to – given the 40% weight in the CPI basket rather –about 0.4 percentage points off inflation, and so if you take labour costs and if you assume labour costs are broadly consistent with the other costs such as cost of capital which they should be in equilibrium. On the margin those labour costs must grow by 1.6% in order to yield the target. You take a labour share of 60%, you have unit labour cost growth of 2 ¾% in order to hit the target given where import costs have historically gone. Now we wouldn't expect import costs to have that contribution going forward given a 19% increase in Sterling. But if we did, we would want wages growing at 2¾% above productivity. We have productivity forecast of 1¾% by the end of our forecast. We are looking for wage growth of 4½% by the end. Now a big grain of salt around all of that.

Let me say two last words on strategy. The first is on this question of risk management approach at the zero lower bound. I guess I would underscore my perspective that we are close to the effective lower bound, we are not actually at the zero lower bound. One of the previous Governors of the Bank of Canada, Gerry Bouey once famously said, famously in Canada maybe, that we did not abandon money, money abandoned us, this was a quote with respect to monetary targeting. We did not abandon the zero lower bound, it abandoned us, we have moved away and we do actually have some room. I haven't been, just to go back to a previous exchange, I haven't been an advocate of waiting and going faster because I have been an advocate of limited and gradual, and I have been an advocate of limited and gradual for some time. Which goes to my final point which is I think we are on track, I take all of the news as being on track, broadly, with May but at this stage the road is still long, it's not the time to tighten policy even absent of events of the past 10 days in my view. Gradual means timely but not just yet.

So to sum up. Martin please.

> **Martin Weale**. Could I make a point of clarification please. What I had remembered from eighteen months ago was a description of other people's results I wasn't suggesting you advocated following such a path.

Governor Carney. In terms of where we all landed up as a provisional indication what I heard was all of us saying no change, no change at this meeting. I believe two or three said finely balanced but we can confirm that, we will have to confirm everything on Wednesday when we meet again. We will have one clear piece of news, we will have the actual Budget. It will have come out in the morning so Dave I hope we can rely on you, if you don't mind reading in a précis of the key elements because I am sure there are elements that we didn't have and if you also actually wouldn't mind bringing the relevant summary tables that would be helpful as well including the comparison tables you showed us last time but we gave back, and then the second thing is we will obviously have more news or fog, more likely, around the Greek situation but we will have some sense more of financial market reaction obviously in that regard so we can do a bit of a stocktake and maybe Minouche I could ask you for that purpose if you can give us the latest from the team on financial markets. And that is that for now. OK. Good.

A meeting of the Monetary Policy Committee was held on Wednesday 8 July 2015. The following members of the Committee were present:

Mark Carney, Governor

Ben Broadbent, Deputy Governor, Monetary Policy

Jon Cunliffe, Deputy Governor, Financial Stability

Nemat Shafik, Deputy Governor, Markets and Banking

Kristin Forbes, External Member

Andrew Haldane, Chief Economist

Ian McCafferty, External Member

David Miles, External Member

Martin Weale, External Member

Dave Ramsden was present as the Treasury representative

The following members of staff were present:

Gareth Ramsay, Director, Monetary Analysis

James Bell, MPC Secretariat

Chris Young, MPC Secretariat

Fergal Shortall, MPC Secretariat

Melissa Davey, Editor of the Inflation Report

Transcript of the Monetary Policy Committee Meeting on

Wednesday 8 July 2015

Governor Carney. So welcome colleagues for this decision meeting. We just had a, obviously the budget, the Summer Budget was announced this morning, we've just had a recap of that by Dave Ramsden at the Treasury and we will drill down on the implications of this through the forecast round. So Minouche given that we've had fast moving events in financial markets and with respect to Greece, obviously related, I think we agreed last time that it would be helpful just to get a quick update in both respects, and so I'll turn to Minouche first and then to Jon.

> **Nemat Shafik**. Let me start with Greece and the market reaction to the last few days' events. The results of the referendum on Sunday came as a surprise to markets but the reaction has been muted relative to contacts' expectations. There have been some swings as the prospects for a deal have ebbed and flowed but as of now the EURO STOXX is down 4% relative to the time we had our deliberation meeting, ten-year bund yields are 23 basis points lower, Italian spreads are 12 basis points higher. Market participants primarily attribute the lack of contagion to the ECB's very explicit support to markets through its PSPP as well as their repeated commitment to further easing if conditions were to deteriorate. The muted reaction in peripheral spreads this week despite the surprise no vote is consistent with this. Further private sector exposures to Greece are of course much reduced relative to the previous crises and participants have taken advantage of the drawn-out period of negotiations to reduce positioning. Despite increased attention by market participants other linkages between Greece and other Eastern European countries, particularly Bulgaria and Romania, we've seen very limited contagion to those markets as well.
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> Let me say a few words about China which has been a bit more exciting. The Chinese equity market has experienced a severe correction in recent weeks with the major indices now 30 to 40% off their mid-June highs and down 10% since our deliberation meeting just a few days ago. Market contacts have cited a number of reasons behind the timing of the correction including a rise in money market rates, a high level of new equity supply via IPO issuance, disappointed expectations on monetary policy and regulatory attempts to reduce market leverage. In recent days the Chinese authorities have made increasingly aggressive attempts to try and avert a further decline in equity prices. Within the official sector, the Chinese Security Regulatory Commission has relaxed rules around the provision of leverage, suspended upcoming IPOs, the same body also committed to increase the capital of the China Securities Financing Corporation, an entity that supplies funding to securities brokers. A high number of listed equities have now been suspended from trading: about 40% of listed equities now are suspended. So far these measures have failed to prevent further falls in Chinese equities. I think today the Shanghai composite opened 8% lower, so it's not working; this has raised concerns obviously among market participants around the risk of policy failures. Now although equity holding have typically represented a very small portion of Chinese household wealth compared to other developed markets, some of course have highlighted potential risks around consumer confidence and investment. As a result while initially limited to the Chinese market in recent days there has been some evidence of spillover to other asset classes most notably commodities where fundamentals were already very weak. I think maybe the most interesting thing this tells us, what it tells us most, is about the Chinese reaction function to market volatility and the likelihood that the stock market becomes even more disconnected from the real economy and the real data.
>
> And then finally I'd just like to say a couple of words on rate expectations because we've had significant movements there too since our last meeting. The sterling yield curve has fallen sharply since our deliberation meeting unwinding the increase in sterling yields we had seen on the month. Ten-year gilt yields are now down 28 basis points since our deliberation meeting on Thursday, down to a level of 1.88 so gilt yields well below 2% now. At the short end the one year one year OIS rate is down 25 basis points since our deliberation meeting and the market curve now reaches 75 basis

points in August 2016 which is considerably further away than when we met. And there is now little if any expectation of an increase in Bank Rate priced in for this year. Of course much of this move lower in yields reflects Greece related flight to quality flows but there also appear to have been some domestic factors in the moves in UK rates at the margin including a surprisingly strong gilt auction yesterday morning and anticipation of a more austere Budget today which may impact on gilt supply, which I believe the DMO has just published its expectations on gilt issuance, which is I think about £6 billion lower than the previous estimate from the last budget.

Dave Ramsden. A little bit higher than expectations.

Nemat Shafik. A bit higher than expectations.

Governor Carney. It should be a bit higher relative to expectations yes.

Nemat Shafik. Expectations were lower which is why I think we saw the fall exactly. So they should go back up I guess.

Governor Carney. They should go back up, yes. I think there are two technical factors layered on top of global market moves which are the strong auction and what's revealed, I mean it's not a technical, it's a fundamental in terms of supply so some of that should settle out and obviously the broader global factors we'll see where that goes so I mean it's a big move in most markets.

Nemat Shafik. Yes, and in four days.

So it's, there are pockets, my observation would be, there are pockets of the tensions that exist around Greece, we'll pick some of them up in longer end yields and pick some of them up in European equities despite the overall situation being relatively well contained. So a positive resolution of the Greek situation about which Jon is about to tell us, I hope, should unwind some of these moves I would expect. So where do things stand?

Jon Cunliffe. [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Governor Carney. Good. Ok the last piece of business before we get to the votes is the advance estimate of the CPI for June. It came in as expected at 0.0 down from 0.1 in May and that's for the twelve month CPI. Yep, that's for the twelve month CPI, the actual month over month, over one month for June is also 0.0. We'll have to get [redacted] to tell us whether that's a big nought or a small nought. In terms of the main downward contributions looking at it on a twelve month basis, so again it went from 0.1 to 0.0, biggest downward contributions, familiar suspects here, transport 5 basis points off, clothing and footwear 7 basis points off, food and non-alcoholic beverages 4 basis points off. And largest upwards contributions miscellaneous goods and services 3 basis points upside and that is from financial services. This will be published Tuesday 14th, next Tuesday, so keep that in mind, we'll have further details then. Right Andy.

Andrew Haldane. Just for completeness, relative to our previous meeting we had the global PMIs for June. They were down a touch from May. That appears to be spread across both manufacturing and services, but with a skew towards the emerging market part of the world. And again, just for completeness, Minouche mentioned commodities, oil prices are down 7% since Pre-MPC.

Governor Carney. Since Pre-MPC?

Andrew Haldane. Since Pre-MPC.

Governor Carney. Good. Alright so now let's go to voting, and I'm going to go in the same order, I'm going to try and go in the same order I did on Monday. So I will start with Ben.

Ben Broadbent. As indicated on Monday I'm going to vote for no change in either Bank Rate or the stock of purchased assets.

Governor Carney. Minouche.

Nemat Shafik. No change; not change**.**

Governor Carney. OK. Martin.

Martin Weale. No change and no change.

Governor Carney. Thank you. Kristin.

Kristin Forbes. No change; no change.

Governor Carney. Thank you. David.

David Miles. No change; no change.

Governor Carney. Ian.

Ian McCafferty. No change; no change.

Governor Carney. No change; no change. Andy.

Andrew Haldane. No change; no change.

Governor Carney. And myself also for no change; no change. So that… Jon.

Jon Cunliffe. I'm going to pause now.

Governor Carney. You're going to pause, here's your chance.

Jon Cunliffe. No change; no change.