BANK OF ENGLAND

MEETINGS OF THE MONETARY POLICY COMMITTEE
September 2015

A meeting of the Monetary Policy Committee was held on Tuesday 8 September 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
Gertjan Vlieghe, 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
Simon Hayes, MPC Secretariat
Chris Young, MPC Secretariat
Melissa Davey, Editor of Inflation Report

Transcript of the Monetary Policy Committee Meeting on

Tuesday 8 September 2015

Governor Carney. Alright so we have two pieces of data, both somewhat weak. IoP for July which will come out tomorrow, the 8th. Month on month growth of -0.4%, which is weaker than the -0.2% expected by staff and the +0.1% expected by the markets. So it will be a surprise. And, within that, the story is manufacturing which is much weaker than expected, -0.8% growth versus 0, flat basically, staff expectations. Energy is stronger than expected. I think that's probably the second month in a row that we've had energy stronger than expected. 0.6% growth versus staff expectation of a fall of half a percent. There were no revisions to the previous month's data. Global manufacturing is weak, including here in the UK. On the trade side, random number generation here! I think that's probably the best we can say about it! Goods exports volumes rose by less than staff expectations on a three-month on three-month basis in July and import volumes less than staff expectations as well. The seasonally adjusted trade deficit goods and services was £4.7 billion in the three months to July compared to £8.9 billion in the three months to April so there has been some pull back there. But, just to give you the numbers, quite weak month on month. We'll find out what's behind this ultimately. Exports goods volumes fell by 9.5% in July and imports goods volumes rose by ½% so that leaves, on a three-month on three-month basis, the outturn for exports goods volumes of 3.8% versus the staff expectation of 6.3% growth. And imports goods volumes falling by 1.9% versus an in house projection of falling by 1.5%. So that is what you call a trade report by any stretch of the imagination! And a pretty weak IoP report as well. Andy.

Andrew Haldane. There isn't huge amounts since last we spoke but let me just mention briefly what has come out. Internationally, the most significant news is probably the US payroll number which you all have seen anyway. US payrolls were somewhat weaker, headline. But, beneath that, the combination of back revisions and a falling unemployment rate and the slightly more positive wage number means that net that looks neutral-ish. In the euro area, I think we mentioned in our Deliberation meeting a slightly firmer set of PMIs for at least some countries across the euro area. The only news we've had since was of course the ECB press conference and the shading down of their inflation and output forecasts. But that's pretty much I think in line with our own euro area inflation and output forecasts. Domestically, we have had data on car registrations for August, which are pretty positive at 4.1%. And we've had the Halifax house price index which was a very positive +2.7%. But this is a pretty bouncy series. So smoothing through different indices over the last three months, rates of house price growth aren't greatly out of line with our August Inflation Report overall but with a lot of bounciness around them.

Governor Carney. So let's turn to the decision and start with you Ben.

Ben Broadbent. Thank you. I'll begin, as usual, with a brief overview of global developments. As it happens, this is where most of the news has been, so I've no doubt others will have their own views.

The key distinction, it seems to me, we should draw currently – one that may not last, of course – is between the weakness of financial markets and data on global activity that are, on balance, still OK. The second quarter releases for GDP saw estimated growth come in a little lower than expected in the euro area, 0.3% versus an Inflation Report projection of 0.4%. GDP in Japan fell 0.4%, below the expectation of +0.3%. But the estimate for the US was revised up, so developed market growth in aggregate was close to expectations. And while there are clear signs of weaker growth, not to say outright recession, in key commodity producers – notably Russia and Brazil – even the hard data for the emerging world in aggregate haven't been undershooting expectations. That applies both to the official estimates for the second quarter growth and, if you believe the way they're integrated into some of these nowcasts – and this is true both of our own and the model I occasionally follow publicised by Gavyn Davies in his blog – to the monthly data since. In the euro area, just to take one example, the PMIs picked up slightly in August. Thus, the figure for UK-weighted global growth was close to expectations in the second quarter, 2½% or so in annualised terms, and looks close to that in the third quarter as well.

Yet, as we know, there has been a significant slide in the price of risky assets in the past month, certainly in equities. The FTSE All-Share index, for example, has fallen by more 9% since our last meeting, the steepest drop between any two MPC meetings since May 2010. The decline is slightly smaller – only 8% – if you exclude the commodity firms. But that's still more than twice the monthly standard deviation.

So what has caused the decline, and what are its consequences?

The common opinion seems to be that, even if economic data in China hadn't worsened, that country is still the main source of the deterioration. The continuing health of official economic data, in the face of a more economic statistics, something that was never that high to begin with. Economic rebalancing, away from industry and towards services, may be distorting the numbers. But it's hard to know.

In addition, and more importantly, the apparent inability to stem either the fall in the equity market, or the outflow of capital, has reduced markets' confidence in Chinese authorities. It also highlights the tension they face between orderly management of deleveraging, on the one hand, and liberalisation of financial markets on the other. Different authorities within China put different weights on these objectives.

Even for super-human policymakers, and even if they had direct control of the banks, it would be a challenge to engineer an orderly deleveraging process, such has been the build-up of debt of various forms in China. How costly that proves, in terms of economic activity, is yet to be seen. But what can we say, as things stand, of any effect on our own economy?

Well, a fall of 9% or so in equity prices represents a rise of perhaps 60 basis points or so in the gross cost of equity capital, including depreciation. Corporate bond spreads have widened quite a bit less than this. So standard estimates of the weighted cost of capital are probably up around 30 basis points or so over the past month. But that's still not insignificant; as Andy pointed out, there are also the potential wealth effects on our own and others savings rates.

So, if this rise in yields is reflected in investment and consumer behaviour, there is clearly the potential for a slowing in global growth rates, including our own, to something below that of potential.

It would be too early, I think, to reach that conclusion yet. The last significant intra-meeting drop in equity prices during April 2010 did, in fact, presage a marked decline in growth here, and elsewhere in the developed world. Similarly, the rebound in risky asset prices in the second half of 2012, particularly banks' funding instruments, preceded the start of the recovery proper at the turn of that year. But these dates represented – if I can use this word – the bookends of the severe phase of the euro area debt crisis.

Governor Carney. Very clever! There is no 'Project Bookend', I'd just like to state that for the transcript!

Ben Broadbent. Whether foreseeable or not, this got progressively worse, and more widespread, over the following two years and that surely a much more direct impact on economic sentiment and activity in the UK than via equity markets alone.

Those markets are volatile, they're prone – as Paul Samuelson once pointed out famously – to misdiagnosis, and any inference about what this does to economic activity in the developed world would probably require confirmation from leading indicators closer to home, confidence and investment intentions in particular.

However, it still seems to me that the case for raising interest rates has nonetheless weakened a touch over the past month.

First, and for whatever reason, those confidence indicators have softened a little. They're coming off high levels, and should not be taken, a drop should not be taken as indicating weaker growth than in our latest projections for the second half of the year, but, for example, the BCC numbers for manufacturing optimism and most of the export surveys, including a release yesterday from the EEF, signal slightly weaker growth in that sector. The services PMI also fell back a bit. As I say, this is certainly no cause for departing from our August forecasts, let alone anything like alarm. But it's in that direction. As Andy noted, if there were to be an independent impact of, or signal from, the fall in asset markets over the past month, that has presumably yet to come through.

Second, and for the moment more important to me, the latest labour market release shows weaker employment growth and, therefore, an acceleration in productivity that, at least in the second quarter of the year, exceeds that in pay. Unit wage costs fell back slightly therefore and their annual growth rate is only around 1%. Again, this may only be a blip. I very much doubt we'll see another drop in

employment in the third quarter judging by the surveys; indicators of labour market tightness point to renewed acceleration in unit costs in the near term, in line with our forecasts. But the latest official data do, at least, indicate a pause in that process.

Taking these factors together therefore, my indicative vote is to leave both Bank rate and the stock of purchased assets unchanged this month.

Governor Carney. Thank you Ben. So I have Minouche and then Andy please.

Nemat Shafik. It didn't take long last Monday for some commentators to argue that the financial market turmoil following developments in China made the Fed (and possibly the ECB and BoJ) should opt for more QE rather than to begin to raise rates. The commentariat piled in with posts from Larry Summers and Ray Dalio and statements from the IMF arguing that lift off should be delayed. Central bankers started to feel like the Grand Old Duke of York, marching people up the hill only to march them back down, and in the end feeling neither up nor down. But as the dust has settled, I think a more nuanced view is emerging.

Several developments we've seen this month do warrant consideration in the setting of monetary policy. And I would like to use my statement today to explain how they have affected my view of (i) how the headwinds will evolve (ii) my four key data points and (iii) strategic directions.

First starting with the headwinds, like all of you my central case has been that the factors which have kept the neutral rate exceptionally low in recent years would continue to ease over the coming quarters. On the month, I've described the outlook as a little softer, but not fundamentally changed.

- As for the world economy, there is certainly cause for concern about the outlook in China and emerging markets more broadly. This is less about the devaluation of the RMB or the decline in the stock market per se, but about an appreciation of the rebalancing challenge they face and the fact that they could, if not careful, use up their considerable buffers to little effect. China is not alone and we are just as likely to see a negative shock from Brazil or Turkey.
- But as we have noted, only 4% of our exports are destined for China (and even less go to other emerging markets). The developments in our larger trading partners have given much less cause for concern. Euro area GDP came in only a little weaker than expected. Meanwhile upward revisions to US growth in Q2 provided a much needed positive surprise
- On the domestic front, near term activity indicators have been a little dreary. Weak CIPS output surveys motivated a small downward revision to the staff's forecast for Q3, and the figures for aggregate lending growth to corporates seem to have plateaued in only mildly positive territory.
- But this doesn't fundamentally alter my view that the domestic private sector will continue to be able to shoulder the burden of the recovery over the coming years in spite of the over overhang of private sector debt. And I find it reassuring that the figures for consumer confidence, secured, and unsecured lending suggests households maintain a similar moderate optimism about the future.

As for my four key data – there has been mixed news.

- Headline inflation turned out about what we expected – though there was some encouraging strength in the core measures.
- The combination of slightly stronger productivity growth and at-the-margin weaker wage growth meant that domestic unit wage cost growth dipped down to 0.9% in Q2 – implying domestic inflation pipeline pressures are still not consistent with generating at-target inflation
- And sterling had a rare down month, being a victim of its own popularity as crowded trades were unwound in volatile markets. The upward pressure this will put on import prices will offer some counterbalance to the slightly weaker domestic inflationary pressures.

So to sum up so far: there have been some signs of softness in the activity and domestic inflationary pressures, though this may be balanced by the depreciation of sterling should it last.

As for monetary strategy considerations, the view I set out last month essentially had two parts:

- First, that the unexpected length of time it has taken for the shock of the financial crisis to work through the economy means we can only have a low degree of confidence in the central case. And in the face of such uncertainty there is merit to waiting before tightening policy.
- And second, that the risks arising from pursuing such a waiting strategy are tempered by the fact that external forces are expected to be a downward drag on inflation for some time to come – thus providing a "buffer" in the form of the expected undershoot of the target.

On these strategic considerations, developments on the month have given food for thought. The alternative to our central forecast for a return to normalcy is some form of secular stagnation, in which global demand is insufficiently strong to match supply even at very low interest rates. At the margin, recent developments highlight a new aspect to that risk, namely that emerging markets may be a source of weakness in global demand in the medium term:

- Historical evidence suggests that a periods of sub-trend growth typically follow the kind of run up in private sector debt that the Chinese and other emerging markets have experienced
- The declining in the oil price will weigh heavily on demand in commodity exporting countries – in particular those such as Brazil and Russia who have limited fiscal space to supplement demand
- And across emerging markets depreciating currencies will increase the burden of sizeable foreign currency debts

As for the external effects on inflation, getting a clear signal is hampered by the fact that movements in currency and commodity markets remain volatile: the average move in the oil price over the past seven days has been 4.4%. Taking a step back, it seems clear that one result of China's actions will be for it to "export deflation" either directly through a lower currency or indirectly by influencing commodity prices. This may, however, be usurped by sterling's depreciation. And only when the dust settles will we truly know the net effect of external forces on the path for inflation.

So dreary domestic data; fatter tail risks in the world economy; cacophonous currency and commodity moves….where does it leave me?

- As for my central case: little changed. I have not seen enough to change my fundamental view that the most likely path is for a continuation of the domestic-demand led recovery in the UK
- As for the risks, the news has probably been offsetting. While developments in the world highlight new aspects to the big risk of global demand deficiency, that may be offset by the 3% deprecation of sterling which – if it continues – could remove the buffer of an expected inflation undershoot

So for this month, I will, like the Grand Old Duke of York, be neither up nor down - I intend to vote for no change in Bank Rate and no change in the stock of purchased assets.

Governor Carney. Very good. So Andy and then Ian please.

Andrew Haldane. Thank you Governor. Over the past couple of months, financial markets appear to have reset their clocks on risks to world growth, at least from China and other emerging market economies. The surprise, in a way, is that this reset has taken so long because this cycle in emerging market fortunes has been several years in the making. In the years immediately after the crisis, around $600 billion of capital flowed into EMEs, on official estimates. Peak to trough, this lowered EME bond spreads by around 200 to 300 basis points. It also raised equity prices and appreciated exchange rates. As capital rotated out of advanced and into emerging economies, so too did growth. Since 2010, annual growth in EMEs has averaged around 6% - three-times that in advanced economies. As a result, EMEs have accounted for almost 80% of global growth, with China alone contributing around half.

Over the past 12 months or so, however, that emerging market cycle has turned decisively. Over the past year, $300 billion of capital has flowed out of EMEs on official estimates. Unofficial estimates have put that number at much higher levels, not least given recent capital flight from China. In response, EME bond yields have risen by over 100 basis points, equity prices have fallen

and exchange rates have depreciated, in some cases significantly. And, as on the way up, where money has lead growth is now following. The IMF forecast that EME growth will slow to around 4% this year and some external forecasters expect it to fall to below 4% next.

It is not difficult to identify the current headwinds to EME growth. Whether or not they result in a fully-fledged financial crisis, many of these headwinds seem likely to be persistent. They include a debt overhang from the credit and capital flow boom of recent years; a significant downturn in the commodity price cycle, which has intensified and generalised over the past couple of months; political instabilities; and the prospect of an imminent tightening of dollar interest rates, in which much of EMEs' overseas borrowings over recent years have been conducted. In the past, this conflation of factors has often presaged a perfect EME storm. And although the epicentre of this storm recently has been China, these headwinds are shared, to varying degrees, by a significant number of other emerging market economies. Put differently, there is a risk we could be entering a third leg of the global financial crisis: after the "Anglo-Saxon" crisis of 2008/09 and the "euro-area" crisis of 2011/12, we could be in the early throes of the "Emerging Market" crisis of 2015 onwards. These three crisis legs have not been independent. To some degree, they have common cause in a slug of global liquidity round-tripping the international financial system. For the first two legs, when that liquidity relocated it had sharp disinflationary consequences, locally and globally. So how much of a disinflationary influence, if any, might an EME leg provide?

Financial markets, as Ben said, do not yet appear to have reached a definitive answer to that question. While international equity markets are down over 10% from their peaks a few months ago, and the short end of the yield curve has eased a fraction, longer-term bond yields are little changed. Certainly, experience at the time of the Asian and Latin American crises from the late 1990s offers some reassurance. Then, advanced economy growth remained robust, at an average of almost 3%, despite financial convulsions in a sequence of emerging markets.

Nonetheless, at that time EMEs accounted for just over 40% of world output, on a PPP-weighted basis. Today they account for around 56%. So the global growth repercussions of an EME slowdown are likely to be greater now than then. So too is their impact on world trade which, notably, has been contracting during the course of this year.

On our own model ready-reckoners, taking various channels together, they suggest a 1% fall in EME growth could slow global and UK growth by between perhaps 0.3 and 0.5%. That size of impact, for advanced economies such as the UK, would be the difference between growing at trend or below it. Globally, it would be the difference between the global output gap continuing to close or reopening somewhat.

One important mitigating factor this time around for commodity-importing advanced economies is the significant improvement in their terms of trade, now not just from oil but from a broader range of commodities. For this to generate a boost to global growth, however, this terms of trade windfall needs not just to be earned but also to be spent by commodity-importers. The evidence on that having happened over the past 12 months is somewhat mixed.

In an environment of post-crisis traumatic stress, there may be an asymmetric response to good and bad news, with good news more likely to be pocketed than during normal times. None of this is to suggest my central view is that recent emerging market wobbles will generate a sharp fall in global demand. But I would view the downside tail risks to the world scene as having become materially fatter since the August Inflation Report.

Coming closer to home, the UK growth picture has remained, in the main, reassuringly solid, at or around trend. And were we to have already seen the worst from EMEs, I would be surprised if those developments were sufficient by themselves to blow any serious hole in the UK's recovery. Nonetheless, almost all of the data we have so far predates financial market gyrations of the past few weeks, so it is simply too soon to tell. I also suspect we may not have seen the worst from parts of the emerging market world.

As it stands, there are already one or two straws in the wind suggesting a slight slowing of UK demand into the third quarter, certainly in employment, and the weaker CIPS survey for August was also noteworthy. Standing back a little, it looks as though UK output growth has been on the

gentlest of downward glidepaths since early 2014. The August IR forecasts had that gentle fall flattening off. The evidence so far is that it may be continuing.

On the nominal side, there was a slight uptick in core inflation measures on the month. Elsewhere, however, domestic costs look to me well-contained. Stripping out bonuses, which have been volatile over the past few months, whole economy wage inflation has remained in the 2 to 3% zone. Although underlying wage growth probably has nudged up during the course of this year, this appears to have been at least matched by productivity growth, leaving unit wage growth at probably no more than 1%, and possibly less. In other words, as with core inflation, there is still at least a percentage point of nominal pick-up needed if the inflation target is to be satisfied.

With possibly more imported disinflationary pressures to come, given the shading down of global growth prospects and the potential for further depreciation in the euro-area and among EMEs, that feels like a distance to travel on the nominal front. For me, it leaves the balance of risks to inflation at the two year horizon skewed to the downside, as it is for households' and companies' inflation expectations.

Against that backdrop, I am minded this month to maintain both interest rates and the stock of asset purchases at current levels. Thank you.

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

Ian McCafferty. Thank you Governor. Good morning. Given my vote at last month's meeting this month's key question – how much might the events in financial markets and the downside news on China affect both the outlook and the balance of risks around our Inflation Report forecast – is particularly important. In poker parlance, do I stick or do I fold?

The latest data on the UK itself is inevitably limited, particularly as little of it postdates the financial market upheavals. Nevertheless, on balance what we have continues to show an economy in which demand growth remains firm, where the labour market looks pretty tight, such that wage pressures are starting to rise, and where in spite of the recent weakness in oil and commodity prices which will slightly prolong the near-term inflation undershoot, underlying inflationary conditions further ahead can still be expected to pick up.

On the demand side the trend in domestic expenditure remains solid. Consumer confidence rose further last month to new highs, conditions for major purchases are deemed at their best since 2003, and the Visa Index of credit cards spending indicates that August was another strong month, particularly for leisure and services. The latest RICS data suggests that the housing market in likely to strengthen into the autumn, which should further support durable spending, particularly as real incomes will continue to benefit from low petrol prices. Meanwhile business investment in the second quarter was again ahead of expectations, supporting the healthy outlook suggested by the investment surveys. Staff have revised down slightly their nowcast for Q3 on the basis of the most recent CIPS data, but the underlying picture painted by the suite of recent surveys is for continued steady growth rather than for any marked slowdown at this stage.

In the labour market the messages from most recent data remain somewhat equivocal, but to me at least are consistent with a picture of little slack remaining. The slowdown in job creation that underlies the weaker employment numbers, combined with the continuing high level of vacancies and the decline in the REC Staff Availability Index to new low levels, are all consistent with growing frictional problems.

I have previously argued that P* and H* are likely to decline as real incomes grow, such that remaining slack as currently exists should be quickly eroded over the coming year or so. And at Pre-MPC staff also signalled that our current estimates of equilibrium may be proving a little high.

This month's wage data provided little concrete news with tightness in the labour market combined with pressures from increases in the national minimum wage and the national living wage through 2016 and 2017 still suggest to me that on our current trajectory the risks to wage pressures are still on the upside by the end of the forecast.

So to the key question, how much is this outlook likely to be changed by recent developments in China and across financial markets?

The honest answer, of course, is that it's too early to be definitive. But I thought that the conclusions to our very good discussion got it about right. That while there is an increased possibility of a marked and disorderly slowdown in Chinese growth, this is still for now a downside risk rather than the central case. And that at this stage the likely impact on the UK is most likely to be limited and contained.

At our deliberation meeting Andy helpfully laid out the possible channels through which recent events could change the outlook for the UK. In terms of the direct route through trade, even in the scenario that Andy cited, with slower growth in China and serious independent downside shocks to other EMEs, the likely impact appears relatively modest. The 1% negative growth shock from both China and other EMEs would directly hit the level of UK GDP growth by about ½ a percentage point over the two to three years. This, were it to eventuate, has already been partially offset by the recent moves in yield curves, the oil price and the exchange rate, which other things equal lift the level of UK GDP by 0.3% relative to our August forecast. With a net downside scenario in which the level of GDP growth is only about a quarter point lower over that forecast horizon, the timing of the closure of the output gap in our central forecast is postponed by about two quarters or so, from second quarter 2016 to about the end of the year. This would make only a modest difference to our inflation projections over the second half of the forecast period.

Were these direct trade effects of a sharp slowdown in EMEs to be compounded by a more general loss of business and consumer confidence across the UK, or disruption via banking exposures, clearly the implications for growth in the longer term inflation prospects would be more marked.

It is still early days but I think it would be an overreaction to proceed on the basis that at this stage these are more than downside risks to be monitored closely. It is not at all clear that the recent financial market upheaval has to have a meaningful impact on UK business and consumer confidence. Stock market volatility is of endless fascination to market commentators but frequently far less so to the members of the public that determine spending and investment decisions. The admittedly very small straw poll of business people that I spoke to in recent days suggest that business confidence remains resilient to the recent market turmoil, such that it would be premature to expect either investment intentions or employment demand to change materially in response.

So, this month I've yet to be convinced that the fundamentals have changed sufficiently relative to our August forecast for me to abandon my concerns about the balance of inflation risks into 2017, once the price level effects of lower oil and commodity prices disappear, and once the economy is performing at full capacity.

But in making my policy decision there are also two considerations about policy strategy that I think important. First I'm very mindful of the need to ensure gradualism after initial lift-off, both to minimise potential disruption in an uncertain economy, and to protect our credibility by not resiling on our earlier guidance.

But what does gradual mean? We've previously said that we intend to be more gradual than in previous tightening cycles in which staff calculate that the pace of tightening averaged some 30 basis points a quarter. To be truly gradual I believe we need to undershoot this with some margin to spare. But where does that leave us? If I go back to David Miles's question of where nominal R* might be by end-2018 in an economy that is likely by then to have normalised further, I get to a level somewhere around 2 ½% maybe up to 3%. To reach that rate starting now would require a pace of tightening of between 15 and 20 basis points a quarter, more rapid than the current OIS curve but to me sufficiently lower than in previous cycles to be a reasonable definition of gradual.

Second I'm strongly of the view that the successful achievement of our inflation mandate means not just returning to 2% over a reasonable horizon but also ensuring that inflation does not go on to overshoot thereafter. I would much prefer a policy path that returns us to 2% inflation gently and asymptotically, even if that meant arriving at the 2% level itself just a little later than could otherwise be achieved.

So to sum up, in the absence of evidence that the economic fundamentals underlying our August forecast have changed materially, mindful of the upside risks to inflation that would imply a more meaningful overshoot by the end of the forecast that we had in our central projection in August, and wary of the risk of compromising our policy of gradualism if we delay too long, I'm inclined this month

to maintain the position that I held last month and am minded to vote for a 25 basis point raise in Bank Rate and no change in asset purchases.

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

Jon Cunliffe. Thank you very much. This month the majority of the news has been on the international side. We've seen a reduction in tail risk associated with Greece leaving the euro zone following its deal with creditors. Though I expect there will be more stress episodes in the future we probably have some months of respite on Greece, the Greek electorate being willing. However, in terms of world growth we've had news to the downside from developments in China and also in emerging markets and some increase in tail risk from that direction.

Even without the recent equity market volatility and using only the official numbers China is clearly slowing. But there are a number of reasons to think China may be slowing more quickly than expected. Industrial production growth has fallen significantly by 1.9 percentage points to 6% since December, as have the staff's preferred PMI measures. And also the backdrop against which the slowdown and rebalancing is to be managed has become tougher due to sluggish growth. The authorities will need to recognise and deal with the bad debts left by the aftermath of the credit boom, and they will almost certainly need to manage the depreciation of the RMB, a difficult thing to do in an orderly and non-destabilising way. These challenges were the subject of much debate at the G20 and BIS meetings last week. And finally, confidence in the ability of the Chinese authorities to manage a smooth transition has clearly been dented. And at the same time, linked, but only partially linked, the prospects for emerging market economies have been deteriorating and the scale of that deterioration I think is now becoming clear.

There are a number of channels through which turbulence and an economic slowdown in China and emerging markets could affect the outlook for growth and inflation in the UK. Andy outlined the key channels last week: trade; financial; confidence/risk aversion. It is hard to know precisely how big each of the channels could be but China is now clearly big enough to impact the UK as well as other EMEs. We have already seen some signs of this through the risk aversion channel - implied volatilities have increased dramatically; we've seen sharp falls in international equity markets; and an increase in corporate bond spreads.

News on the rest of the international picture was mainly positive. In the US Q2 growth was revised up sharply; business investment growth was strong in July; and unemployment fell to 5.1% in August although non-farm payrolls increased by less than expected, though I understand on past experience that figure may be revised up pretty quickly. On the other hand, Euro zone growth disappointed a bit in Q2. But staff have stuck with their near-term forecasts for both the US and the euro area.

So overall, there is downside news on world growth, and there is less tail risk from Greece but more tail risk from Asia.

There was a mixture of broadly offsetting news domestically. The main news for me in the Q2 expenditure split was consumption growth which at 0.7% was weaker than the 0.9% in the Inflation Report forecast and the 0.9% outturn in Q1. Looking ahead, staff have already marked down their nowcast for Q3 growth by 0.1 percentage point to 0.6% partly on the back of that weak reading in the Markit/CIPS output indicator which fell to its lowest level since March 2013 and most responses there predate the acute phase of the turbulence in China.

However, on the other side, consumer confidence ticked up in August and remains near historic highs; monetary conditions have eased as the yield curve has moved outwards a little; and sterling has fallen by around 2%. When you put all this news together I don't think it points strongly in any particular direction, although I'll be watching closely the evolution of consumption growth in case the Q2 figure turns out to have been a straw in the wind.

There is clear evidence of some good news on inflation and inflation expectations. Headline inflation was slightly higher in July than we expected. But it's the movement in core inflation on a range of measures that is perhaps more noteworthy. The ONS measure of core inflation increased from 0.8% in June to 1.2% in July, and that's higher than the 0.9% that staff were expecting. And going in the same direction the principal component of 26 different core measures increased in July to 1.1%

from 1.0% in June and 11 of the 26 measures were higher than 1.1% in July. And that is consistent with a firming in underlying price pressures and again something I will be watching closely.

In addition to the news on core inflation I think, there was also some reassuring news on inflation expectations which remain broadly in line with our inflation target, and I note – although it's an imperfect measure of inflation expectations – the balance of consumers in the GfK/EC consumer confidence survey saying that now is the right time to make major purchases is at the highest point since 2003. So that just confirms to me that the risk of persistent low headline inflation, kicking off a deflationary mind-set, is certainly not crystallising.

And finally, on the labour market, there are at least two plausible stories to describe the recent fall in employment and hours. One is the congestion/we have hit-the-stops story. Another is that we are seeing a faster than expected pickup in productivity and as a result a slower than expected reduction in slack. Consistent with that, although only one reading, productivity growth in Q2 was 1.0%, which was 0.2 percentage points higher than expected in the August Inflation Report.

There are a number of reasons to think the inflationary pressures in the labour market are not yet building markedly. Slack does not now appear to be reducing quickly. Other indicators such as resignation rates and voluntary job to job flows, which we've been looking at, declined slightly in Q2 and remain below their pre-crisis levels. Moreover, the unwind of compositional effects has conceivably been a significant driver of the recent pick up in pay rather than the intensification in underlying wage pressures. And labour cost growth remains pretty muted, for example, whole economy AWE-based unit wage costs are estimated to have grown 0.9% in the year to Q2 versus the staff's expectation of 1.2% due to weaker than expected pay growth. And, as Ben has pointed out, there are lags between slack and wage growth so the recent pick up in wages is likely to be a reaction to previous falls in unemployment and not necessarily a response to more recent developments in slack.

I'm not saying that pressures are not building in the labour market – indeed I hope they are as we need that to push inflation back to target. But the evidence is not yet that pressures are building at an increasing rate or at a rate that would support policy action now to ensure that we do not overshoot our target as the effects of imported disinflation – which will continue for longer than we had anticipated – wear off. And after saying that productivity would return, and serially being wrong, I don't want to make the opposite mistake and underplay the recent positive signs on productivity.

To sum up, international news this month has been to the downside; domestic news was broadly neutral; and it is still unclear which story best describes the evolution of the labour market.

So on the back of that news, I don't think my big picture view of the outlook has changed materially. There is a question about whether market volatility will grow or fizzle out. And I worry about developments in China and particularly in emerging markets, including the possible interaction with US policy normalisation when it starts. On the other hand the movements in core inflation may be signalling a more sustained pickup in domestic inflationary pressures.

Finally, one hears a lot of references to data dependency, and I guess we are all data dependent now, but I think we are in a truly data dependent and not a time dependent or tightening rhythm dependent period. My strong expectation is that the next move is up and that we are getting closer to that point. But it is by no means certain. And as we had demonstrated we do not understand the domestic post-crisis economy that well and the external post-crisis environment can generate surprises – witness the commodity price shocks of the last year. So I am truly data dependent – I want to see data on the build-up of domestic inflation pressure and of the waning of imported disinflation.

Given this assessment, I see no case to change my policy stance so I vote provisionally for no change in Bank rate and no change in the stock of asset purchases.

Governor Carney. Thank you very much Jon. So Martin and then Kristin please.

Martin Weale. Thank you Governor. In the past both Kristin and I have commented on the domestic tug of war, between quantity developments, particularly in labour markets, and wage and price developments. Over the last month it seems to me that a different sort of tug of war may be

developing, between domestic pressures and some international forces. Of the advanced economies, the United States looks a bit more buoyant now than seemed to be the case a month ago. Growth in the euro area in Q2 was slightly disappointing, but the short-term indicators for Q3 do not point to any underlying weakness, at least relative to rather modest expectations. So far it does not seem that the Greek crisis has affected performance materially during Q3. Nevertheless, developments connected with China have led to substantial concerns about the international environment. At the same time despite some weakness in the current quarter, especially in manufacturing, the underlying forces driving domestic growth probably remain in place.

My sense is that the Chinese question needs to be considered in two parts. First there is the effect of the market disturbances. Secondly there is the broader question of the prospects for both China and the other developing countries and the implications of those for the United Kingdom and particularly for UK inflation. It is possible that some of the international consequences of developments in China so far have been amplified by the silly season. But market volatility has continued into September.

I find it difficult to believe that China is materially exporting deflation to the UK as a direct result of exchange rate changes. It is true that the yuan fell after the devaluation. But it's hard to see a pattern against sterling over the past year or so. At present therefore I cannot see why I should worry now more about exchange rate deflation exported from China than a year ago, when circumstances seemed to me to justify an increase in Bank Rate.

More generally, lower prices of imported commodities increase the UK's real national income leading to increased demand. Andy suggested that the combined effect of the changes that have taken place since the Inflation Report would be to add 0.3% to GDP by the end of the forecast period. The balance of the asset prices changes is probably, given the movement in the exchange rate, also adding slightly to inflation at the two year horizon.

This provides the backdrop against which to consider the effects of possible weakness in China. Our ready reckoner is that 1% weakness in China depresses UK GDP by 0.1%, although there is the possibility that China's increased size means that the 0.1% figure should now be a bit larger. To me, market price comparisons seem to be more helpful than PPP comparisons. Anyway this figure is a combination of trade effects and the offsetting income effects from lower commodity prices which are already included in the earlier 0.3% I mentioned above. So perhaps an overall guess, allowing for weakness in China so far is that things are likely to be largely neutral for UK GDP and inflation. There is also, however, the question of home-grown weakness in other developing countries. Staff analysis in late 2013 suggested that a downturn focussed in five of the most vulnerable developing countries and China, with an average impact of 1% on the domestic demand of all developing countries, would subtract 0.5% from the level of UK GDP after two years.

So, the point I take away from this is that weakness in China needs to be substantial to have a material net depressing effect on output relative to our forecast, and that there is probably little effect on inflation at the horizon which concerns us. If, however, China's problems are compounded by significant weakness in other developing countries, then an important downside risk to inflation and output does develop.

So the question whether recent developments associated in China will have a more global impact, though comes up, perhaps working through effects on confidence in the developed economies. Arguments why that should be the case include weakened confidence in the way in which China can manage its economy and perhaps concern that a policy of market liberalisation may once again be seen as a right deviation. My own sense is that, while some people may have assumed that China had discovered a smooth path of economic growth, most won't be terribly surprised to see disturbances from time to time. Similarly, weakness in other developed countries after a period of rapid growth is hardly a surprise and more what is normal. So my overall instinct is that, while the direct downside risks we described in August may be a bit larger than we had thought, despite the reduced risk associated with Greece, this confidence risk, while present is not as yet material.

We had a thorough discussion of the domestic risks coming from the balance of payments. I am reluctant to contemplate policy changes to address possible financial stability issues without explicit guidance from the FPC. If, however, the FPC were to consider it appropriate to take some form of restrictive action to limit domestic credit growth then it would obviously be right for us to respond to

the implications of that for inflation, in much the same way as we set monetary policy taking account of the Government's fiscal policies. Obviously it has been helpful to think about that in advance. The question was raised whether recent tax changes for banks might limit the scope for further reductions in interest rates, I remain confident that alternative instruments are available to us should they be needed. My own work on asset purchases suggested that they were effective even in the absence of financial market stress.

If China is a downside risk rather than, so far, a net source of net downward pressure on UK growth and inflation, perhaps the decision this month has also to focus on other, largely domestic factors. There are conflicting signals. Productivity growth has been a bit larger than we thought in August while wage growth, both in the economy as a whole and in the private sector, has been weaker. I am not sure how far these effects should be expected to have a material effect on modal inflation in two years' time, but they do lower my expectation of the inflation rate a little and perhaps that is just as well, given the prospects for inflation during year three.

Working in the other direction has been the buoyancy in the measure of core inflation, which rose to 1.2% in July. This movement is harder to interpret than wage and productivity growth, because it is not clear which component of costs has accelerated. But it has to be seen as an upside risk.

Overall, I remain concerned about the effects of the tightening labour market, nevertheless, and in particular the prospects for pay growth, perhaps augmented by the effects of the national living wage. In the light of that it seems to me that policy will need to be tighter than the yield curve implies. Nevertheless, I do not think an increase is justified quite yet. I expect to vote once again neither to change Bank Rate nor the stock of assets.

Governor Carney. Great. Thank you Martin. Kristin and then Jan.

Kristin Forbes. I've been on the MPC for just over a year. I thought I'd follow a precedent Jon set on his one-year anniversary—to take a big picture look at monetary policy over this period—and if it makes sense when viewed through the lens of a year rather than monthly increments. In other words, the boiling frog test. This was a good decision in hindsight given my spot at the end of the queue today and that all the domestic data has been well covered.

My first year has often felt like hurdle after hurdle on the journey to begin increasing interest rates. At times I couldn't help but think of Odysseus as he set sail after the Trojan War and had no idea of the unexpected delays to get home.

When I began last summer, the UK appeared to have finally settled into a solid and sustainable recovery. The August IR forecast GDP growth of 3.5% in 2014. Business investment was finally picking up and building on strong consumption to generate more balanced domestic growth. Unemployment had fallen rapidly, and slack was predicted to soon be eroded. Housing prices were increasing strongly. Banks were lending and financial constraints had eased substantially for most firms (except the smallest).

After a devastating crisis and prolonged recovery, last summer the economy was finally beginning to look more normal. The numerous constraints to growth from the crisis—most importantly the need to rebuild balance sheets and the financial system—had taken years. But by last summer these substantive drags had largely diminished. Other drags would continue—such as from fiscal consolidation and weak demand in the euro area. But the UK recovery was solid enough to overcome these and appeared to be nearing the point when an increase in rates would be appropriate.

But one critical piece was missing—wage growth. If wages did not pick-up soon, continued recovery would rely on consumers drawing down savings at unsustainable rates. Low wage growth also raised questions about whether there was more slack than we believed—or simply another effect of the severe crisis. Delaying an increase in rates was appropriate until we had more clarity.

By the end of 2014 though, wages began to turn around. Annual wage growth was above 2% in Q4. New evidence suggested the previous wage weakness had been driven by stronger labour supply and "composition effects". An unexplained weakness in wages was becoming less of a hurdle to begin increasing rates.

But then another hurdle—sharp falls in energy and food prices. Inflation fell sharply to reach -0.1% in April and was expected to stay close to zero for several months. Although our analysis showed that low inflation would be temporary and could largely be explained, the unprecedented low level—especially when combined with low inflation globally—raised several risks. Would near-zero inflation give companies a reason to avoid raising wages? Or cause inflation expectations to decline? Since domestic price pressures were so muted, there was little risk to waiting until these questions were resolved.

By spring 2015, these risks had largely abated. Wage growth had been faster than expected over the first six months of 2015, although some additional time could ensure headline inflation was recovering.

In the summer of 2015, however, another risk emerged. Greece. No need to say more. Although the direct risks of contagion to the UK appeared manageable, there would be spillovers and contagion often occurs in unexpected channels. Given the lack of domestic inflationary pressure in the UK, it was prudent to wait to see how Greek negotiations played out. And just as this risk abated, others have emerged from abroad. Sterling has been appreciating and commodity prices continued to fall. Uncertainty about China's economy and market volatility have increased sharply. This has spurred sharp falls in equities around the globe, large exchange rate movements, and shifts in capital flows—increasing vulnerabilities in some emerging markets. It is not yet clear if there will be any significant, persistent effect on the UK economy. Even if there is some effect, it is unclear these would derail the outlook for a continued, solid recovery.

Despite this seemingly never-ending series of hurdles, what has been striking over the past year is the relative stability in UK growth and our forecasts. And these foundations for solid growth remain in place. Growth has been 0.7% or higher for five of the last six quarters, and is expected to continue around this level for five more quarters, albeit at 0.6% in Q3. Consumption should continue to be supported by lower oil prices, real wage growth, and positive confidence. Relatively easy lending conditions and momentum in demand should continue to support investment.

Our inflation forecast may need to be adjusted to reflect the recent falls in commodity prices, currency movements, and changes to growth from lower borrowing costs and oil prices and weaker trade. However these tweaks balance out, though, inflation should still be on track to begin picking up by the end of the year towards target.

Going forward, when will I feel confident enough in this forecast? When will inflation be showing enough positive momentum that I will think it is appropriate to begin raising rates?

First, are there any implications of recent weakness in emerging markets and market volatility for the UK? I believe we should largely look through normal gyrations in financial markets when setting monetary policy. But do recent movements imply greater weakness in emerging markets, especially when combined with the global weakness in trade and manufacturing? Could these affect UK exports or financial vulnerabilities in a meaningful way? Will risk aversion increase permanently? Will there be a meaningful wealth effect that reduces consumption? Although I don't put a high probability on these risks materialising, they should be monitored.

Second, how will recent exchange rate movements impact inflation? The magnitude and timing of this "pass-through" is critically important for inflation, as we all know. Recent evidence suggests that although pass-through has been substantive, it may have been less than in the past. If this continues, or sterling's recent depreciation accelerates, it could imply less drag on future inflation.

Finally, will core and domestically-generated inflation pick up? Given structural changes in the economy, it is impossible to put any precise estimate on the output gap today. My reading of the recent labour market indicators suggests that there is little remaining slack (if any). This would normally imply a solid pickup in wages and other production costs. The many factors dampening inflation have made it harder to assess if this is beginning to occur. And if productivity continues to recover, a very big unknown, this could moderate any pickup in labour costs.

In addition to these considerations for the outlook, other unexpected hurdles will undoubtedly emerge. Over the past few years, most of these hurdles have presented valid reasons to hold interest rates constant and they may push in the same direction in the future. But they may also

push in the opposite direction. For example, if the recent recovery in the euro area continues, this could counterbalance broader weakness abroad.

There will always be surprises and uncertainty, and that in itself is not a reason to delay an adjustment in monetary policy that makes sense for the UK. Low headline and stable domestic inflationary pressures have provided us the luxury of time to evaluate the uncertainties that emerged over the last year. But this luxury of low inflation is unlikely to last for much longer. Odysseus' strength helped him overcome everything from the Cyclops to cannibals to the six-headed monster Scylla to the whirlpool Charybdis—and eventually return home. Similarly, the underlying strength of the UK economy should help it withstand new hurdles and weakness abroad. The journey to begin raising rates should be less prolonged than Odysseus' 10-year voyage back to Ithaca. Although I will not vote for it to begin this month.

Governor Carney. OK. Thank you very much. You didn't tie yourself to the mast there or anything. That's good. All right Jan, top that! Welcome by the way.

Gertjan Vlieghe. First of all I would say I feel enormously privileged to sit in this room and participate in discussions that will actually culminate in a monetary policy decision. It's great to move out of the commentary box and onto the field.

Since it is my first meeting, I thought I would set out briefly my big picture views, before turning to the specifics of this month's decision. You will have heard all of these arguments before. I am making them not because I think they are new, but just to let you know that I put a lot of weight on them.

I think we are living in a world of persistently low growth and persistently low interest rates, driven in large part by debt and demographics.

Since the financial crisis, some countries have repaired their balance sheets after a rapid pre-crisis debt build-up.

The US has made the most progress, reducing household, and, to a lesser extent, corporate debt burdens and recapitalising banks, while increasing the government debt burden. Even if the aggregate US debt burden has not been reduced, it still counts as balance sheet repair, because the debt burden has shifted to sectors that are better able to bear the debt

The UK, I think, is the next best performer in terms of balance sheet repair. Having done relatively less household sector deleveraging, but more corporate sector deleveraging than the US.

The picture is quite different, however, in the rest of the world. There are areas that have done much less balance sheet repair since their debt peak, the Eurozone as a whole is a prime example, and there are areas that have continued to increase their debt burden since the financial crisis; many emerging markets fall into that category, including, of course, China. In aggregate, the global debt burden has continued to increase all the way through the post-crisis period.

Reducing debt after a significant build-up is a process that tends to create a severe headwind to growth. In the absence of mechanisms that allow outright debt reduction or restructuring, reducing debt burdens without a sharp collapse in activity usually involves a period of little or no credit growth while allowing nominal income growth to erode the debt to income ratio. This process requires a prolonged period of nominal interest rates below nominal income growth. In countries where real growth is low, that tends to correspond to negative real interest rates. Since nominal interest rates cannot go much below zero, the debt ratios are only being reduced at the pace of nominal income growth at best, so the process of balance sheet repair is slow, it takes many years.

A second driver for low growth and low interest rates is, I think, demographics. The growth of the global working age population has fallen sharply in recent years, by around ¾ of a percentage point. There are two aspects of this that I think are insufficiently understood or appreciated. First, although it has been happening for some time, the pace of the slowdown intensified in the past five to ten years. And second, it is not just a developed economy story. It is happening in Russia, Eastern Europe, in Latin America and of course in China.

A global decline in workforce growth means less investment demand, leading to a lower real GDP growth. This in turn means it will take longer to reduce the debt burden, so a longer period of low interest rates is required.

It is not the case that monetary policy is therefore powerless. Monetary policy is doing a crucial job of keeping real interest rates as low as possible, by ensuring that inflation expectations remain anchored to the target even as policy rates in many areas remain close to zero.

This is absolutely essential because if inflation expectations and therefore nominal growth drift down the repairing effect of low policy rates on balance sheets is dangerously reduced. I think this framework of debt and demographics offers a potential explanation of why global growth is not improving yet despite many years of record low interest rates. I am quite open-minded about the possibility that the global equilibrium real interest rate is at its lowest for many decades, and set to stay there for several years still, or rise very slowly at best.

Let me now turn to some specifics on the UK, and today's decision.

We have experienced a welcome period of growth above potential in the past two years. That has significantly reduced slack in the economy. A continuation of growth above potential would require monetary policy tightening at some point, although "limited" and "gradual" due to the low level of the equilibrium real interest rate.

However, growth has slowed. Many growth indicators, including GDP growth itself, are down from their peak in the first half of 2014. With a lag, employment growth has slowed as well, which is not just evident in the official LFS data but also in the claimant count, in vacancies, and in some private sector surveys such as the REC.

At the same time, we have seen some improvement in productivity growth in recent quarters, which is now at or near the strongest pace in three years on most measures.

Slowing demand growth and rising supply growth has resulted in the unemployment rate stabilising in the past four to five months. It is no longer obvious that growth is still above potential right now.

Moreover, we are about to enter a period of more severe fiscal retrenchment: the planned reduction in the cyclically adjusted primary deficit is set to average 1.2 percentage points per year over the next three years, whereas it averaged 0.1 percentage point over the past three years. And the global growth environment, outside the US, is becoming less favourable, both in terms of central forecasts and balance of risks.

Not all UK domestic indicators suggest slowing growth. Consumer confidence is at cyclical highs, car purchases are strong. The housing market, which slowed substantially last year, is improving again, both in terms of activity and price growth. So it is possible that we will see a more broad-based renewed pick-up in demand growth, but I would like to see a lot more evidence of it to believe it.

Arguments for a monetary tightening do not solely hinge on seeing growth above potential. A case could also be made based on the fact that previous growth above potential has already reduced slack to such an extent that generalised price pressure in the economy is building up. The rise in wage growth evident in ONS data supports that argument, as does evidence of rising skills shortages.

However, while the acceleration in wages is encouraging, the growth rate of wage costs is still too low. Unit wage cost growth was just 1% in the year to Q2. Moreover, the evidence of the wage acceleration is not yet, to my mind, sufficiently broad-based across pay indicators to be reliable.

To tip the balance in favour of a monetary policy tightening in the future, I would need to be quite a bit more confident that the rise in domestic cost inflation will continue. The evidence I am looking for is either direct evidence of further strength across a wide range of wage and price indicators, or, a change in the balance of demand and supply growth that makes me more confident that we are growing above potential again, and that the unemployment rate will resume its downward path.

In conclusion, I am inclined to vote for no change in Bank Rate and the stock of asset purchases.

Governor Carney. Thank you very much Jan. It turns out I'll pick up on some points you said by conducting a bit of a thought experiment. But let me begin by just underscoring what I see as the broad dynamics underlying our policy strategy, which is we are trying to balance two large forces. Domestic strength versus global weakness. We see these effects show up in the underlying components of CPI, with its prospective return to target relying on the firming of domestic cost pressures offsetting the drag from imported inflation. And this is a balance that obviously is relevant over the policy horizon, long after the effects of the oil shock have passed through.

In recent months we've been saying, as it turns out a little more presciently than we'd anticipated, that risks were rotating to emerging markets. In recent weeks, some of these risks have begun to materialise. I'll just associate myself with Andy's comments in terms of the order of magnitude of emerging markets in proportion of the global economy. I will give you a general sense that the general malaise in emerging markets, at least from a policy-maker perspective, is quite widespread and the degree of nervousness is quite widespread. In fact, India stands now as one of the only emerging markets of substance who feels that they have a balance of policy that is right. And, summed up by one peer, who said that what emerging markets are going through is that, in addition to domestic circumstances, are three major re-pricings. The re-pricing of the RMB, the end of the commodity super-cycle and the re-pricing of the US dollar and dollar interest rates. And I will come back to that first one when we have a discussion next time.

Now these risks in emerging markets compound what is already a very low nominal growth picture. In the years before the crisis, global nominal GDP averaged 10% a year. In the years since the crisis, it's averaged 2.5%. If you look at China, nominal GDP growth has fallen by more than two-thirds. So when you go to the challenges of deleveraging that's one of the factors that is dominating, it is one of the factors that is really weighing on the global outlook.

With respect to the headwinds in China that have become more apparent, I do expect that the Chinese authorities will lean heavily against these for a while, consistent with our conversation of a few days ago, so that the outturns will be something more. It may be a little softer than what is predicted but in terms of policy measures they will take in order to try and achieve short-term objectives. But doing so will fatten tail risks, which will likely manifest over time in sharper exchange rate developments. I think the balance of risks in the RMB is very much to the downside, and it is an issue on how well it's handled, but this is a major shift in the global landscape.

Now set against somewhat disappointing global developments – I wouldn't overplay the disappointing, I would accentuate, as others have, the rising global risk – today's data notwithstanding, domestic news has been broadly in line with expectations. I would say there is little overall though in the data that would justify pulling forward a first rise in Bank Rate, which at least in our August forecast was consistent with market pricing of a full lift-off in the second quarter of 2016, which was the point where the OIS curve reached three-quarters of a percent. Now there's lumpiness around that quarterly profile and you can see different things. So I'm just going to do a thought experiment considering a first rise in Bank Rate in the first quarter and ask what would we see at that point given our forecast, and how confident might one be in order to take that decision.

At that point in Q1, GDP will have grown on average above 0.7% per quarter, having posted those rates for over a year. Annual growth about 2¾%. Unemployment about 5½%, having fallen only about 10 basis points from its current rate. That momentum would be entirely the result of robust private domestic demand of a full 0.5 percentage points of the 0.7% quarterly growth coming from consumption, and the balance from business investment. We will have had a few years of consumption growing at rates north of 3% and business investment we expect at that point to be accelerating. So the real side will look relatively robust, subject to the cautions a number of you have made, but that's the expectation. And that would be the best card in terms of giving my perspective in terms of justifying rates.

On the nominal side, we forecast wage growth of around 3½% annually. It will have accelerated by about a percentage point from its current rate. It will still be below its pre-crisis average. And we would expect average weekly earnings based unit wage cost growth of about 1½%, so about 1 percentage point below its pre-crisis average. And that, given the data that we would have in first quarter, that is consistent with our nowcast. Just to put that in context, in the run up to the crisis, I've quoted these figures before, given the 40% weight of imported goods and energy in the CPI basket, on average those components grew at about 1% in the decade after '97. In order to deliver the target, we need labour cost growth of about 2¾%. The imported headwinds we have are much more material than the experience we had, or at least that is what our expectation is; that the headwinds will be more material than those we had in the run up to the crisis.

So we will have some acceleration in domestic cost growth, but it may feel a little uncomfortable, particularly if global headwinds are gathering. We will have CPI to December. Currently we expect a 0.6% at that point, obviously heavily influenced by imported weak energy costs and lower utility costs. For what it's worth, and I don't think it's worth that much, but we've never initiated a tightening cycle with headline inflation that low but there's a first for everything. But it does mean that I think we would need to rely more heavily on core inflation, and build a case with core inflation and a richer discussion and analysis around it. And it's not perfect either but there is, from my perspective, a communication challenge that would exist since we would be relying heavily on a forecast.

Core inflation, we expect with the STIF, to be 1.6% in December, and recent developments in core, albeit influenced by clothing and footwear, are somewhat encouraging in that. I would highlight though that the build in inflation from that point in our forecast relies heavily – to the extent of 0.3 percentage points – on an "unaccounted for" item. This is something that we have inserted in terms of prices building and we have different priors about what it captures but, in terms of our core relationships, it is not clear that we will get further acceleration at that point. To my mind, that puts further weight on the need to see wage costs building, and to see core coming through, in order to feel confident that that is the point at which to begin to tighten policy.

In terms of whether the August forecast is on track, absent global risks, I would say on the first order yes. On the margin, I would say healthier Q2 productivity and lower associated unit wage costs, combined with the dogleg in unemployment suggests more, not less, slack in the labour market. From my Q1 calculation of lift-off, for what it's worth, it's fortunately too early to have to make that call.

Let's finish up by going to this question of gradualism. One can get to different numbers and there's no precision on R*, as we well know it's unobservable. What is observable is our past paths of tightening cycles. I'm doing this from memory but since we adopted inflation targeting, and since we had tightening cycles, you can get two averages for average tightening cycles. One is 37½ basis points and the other is 50 basis points and that depends on whether you treat one of the tightening cycles which has a fag-end, if you will, of additional hikes that come in 9 or 12 months after the tightening cycle comes in. So to my mind keep it down at 37 and you know…

Ian McCafferty. I quoted 30, which was the staff calculation of the first four rate rises.

Governor Carney. I think this is a matter of facts, so why don't we circulate again what they are, but I'm pretty confident. I also think it is right that since '97 the biggest tightening cycle we have had, the biggest delta in a tightening cycle, is 150 basis points. And that's the flip side, I agree with many things that have been said here in the past, but sometimes it's argued that one of the issues is that UK households are not very sensitive to interest rates and so you would have to move a lot in order, if you don't start in a timely fashion, you have to move a lot in order to have an impact. Actually it goes slightly the other way, UK households are very sensitive to interest rates. That's one of the reasons why tightening cycles in my mind, you know looking back at them, tend to be much shallower, in total, than tightening cycles in other advanced economies. And there has been a shift towards greater fixed in terms of mortgages, but that's fixed for two years, and so over the relevant horizon it becomes operative. So being at 50 basis points in Q1, even sitting here from today, there's still 10 quarters left in order to get to the end of the forecast horizon. If it's 150, that's 15 basis points a quarter. If it's 200, that's obviously 20 basis points a quarter. 250 certainly would be a material tightening, I would think, and particularly material tightening in a world where we're not overshooting at the end of the forecast horizon. But we are overshooting at the end of the forecast horizon (because we could have an overshoot) and if anything, to my way of thinking, it just puts very strong weight of evidence on this economy continuing to grow above trend, our estimate of trend, and those actual wage costs beginning to build and seeing it to flow through to core inflation so that we can initiate a process in a likely environment of global weakness, in an environment where we are relying very heavily on our forecast to justify policy. So with all that, at the present time I am inclined to vote for no change in Bank Rate and no change in asset purchases.

We will confirm that vote, we will meet tomorrow and get any additional data, any additional developments, take stock and have a final vote and review the Monetary Policy Summary tomorrow.

A meeting of the Monetary Policy Committee was held on Wednesday 9 September 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
Gertjan Vlieghe, 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
Simon Hayes, MPC Secretariat
Chris Young, MPC Secretariat
Melissa Davey, Editor of Inflation Report

Transcript of the Monetary Policy Committee Meeting on

Wednesday 9 September 2015

Governor Carney. Continuing on I will ask for final votes on our decision for September and I will start with Ben.

> **Ben Broadbent**. I confirm my vote for no change in either Bank Rate or the stock of purchased assets.

Governor Carney. Minouche.

> **Nemat Shafik**. No change, no change. Same vote as I mentioned yesterday.

Governor Carney. Right. Andy.

> **Andrew Haldane**. No change, no change.

Governor Carney. OK. Ian.

> **Ian McCafferty**. A quarter point raise in Bank Rate. No change to asset purchases.

Governor Carney. Thank you. Jon.

> **Jon Cunliffe**. No change, no change.

Governor Carney. Thank you. Martin.

> **Martin Weale**. No change to Bank Rate, no change to asset purchases.

Governor Carney. Kristin.

> **Kristin Forbes**. No change, no change.

Governor Carney. Jan.

> **Gertjan Vlieghe**. No change to Bank Rate, and no change to asset purchases.

Governor Carney. Have I missed anyone, I normally have missed somebody by this point? OK, I also vote for no change to Bank Rate and no change to asset purchases. So to confirm, we have one vote for a 25 basis point increase, which is Ian. Eight votes for no change to Bank Rate and all votes for no changes to asset purchases. Very good. Thank you very much so I will close the official bit of the meeting. And we will proceed to the room to draft the Monetary Policy Summary and the Minutes.