BANK OF ENGLAND

MEETINGS OF THE MONETARY POLICY COMMITTEE

December 2017

A meeting of the Monetary Policy Committee was held on Monday 11 December 2017. The following members of the Committee were present:

Mark Carney, Governor
Ben Broadbent, Deputy Governor, Monetary Policy
Jon Cunliffe, Deputy Governor, Financial Stability
Dave Ramsden, Deputy Governor, Markets and Banking
Andrew Haldane, Chief Economist
Ian McCafferty, External Member
Gertjan Vlieghe, External Member
Michael Saunders, External Member
Silvana Tenreyro, External Member

Richard Hughes was present as the Treasury representative

The following members of staff were present:

James Bell, Director, Monetary Analysis
Sarah John, MPC Secretariat
Bob Hills, MPC Secretariat
Simon Hayes, MPC Secretariat
Matthew Tong, Deputy Editor of Inflation Report

Transcript of the Monetary Policy Committee Meeting on

Monday 11 December 2017

Governor Carney. Good morning, everyone. We will start with two pre-releases today. First, on labour market statistics: there's no news on wages – at least relative to expectations; there is a bit of downside news on quantities. Three months to October, employment rate flat at 60.7%, slightly weaker than staff expectations of 60.8%, and was associated with 56,000 fewer people in work than in the three months to October.[1] Unemployment rate flat at 4.3%, slightly weaker than staff expectations of 4.2%. The inactivity rate was 36.6%, in line with staff expectations. Three month average AWE total pay growth (so including bonuses) 2½%, bang in line with staff expectations. Whole economy AWE regular pay (in other words excluding bonuses) was 2.3%, in line with staff expectations. Average hours worked was 32.0 relative to expectations of 32.2. OK. CPI….. this just in. 3.1. We've got to write a letter! Where's that draft letter, Ben?

Ben Broadbent. It's on the stocks the whole time.

Dave Ramsden. Just change the date on it.

Governor Carney. It's like an obituary, we've got it all written out. We don't have a lot of information. 0.3 for November is the advance estimate, which brings the 12 months through to November to 3.1. You'll recall staff expectation for the STIF was…

Ben Broadbent. Three

Governor Carney. …was three, exactly. Although we anticipated there was obviously some possibility of this. So there is not much detail. The largest upward contribution to the change in the 12 month CPI came from transport, principally from airfares. So prices in transport as a whole up 0.1% between October and November this year compared to a fall of 0.4% between the same two months a year ago. Recreation and culture also had an upward effect, with the prices of games, toys and hobbies rising between October and November this year by more than a year ago. This came from computer games, whose prices are heavily dependent on the composition of the best seller chart, often resulting in large overall price changes from month to month. So that's replaced Star Wars I should think.

Ben Broadbent. You should have a sort of hedonic adjustment. Anyway.

Governor Carney. You would have to get a 12 year old to do the hedonic adjustment accurately. So that's the story. This comes out tomorrow morning. The labour force does not come out until Wednesday. So we'll get the core and all the detail tomorrow morning. But in terms of our remit, just so we are all on the same page and so that people know, if inflation moves away from target by more than one percentage point in either direction, we are due to "send an open letter to the Chancellor covering the considerations set out above…" blah, blah, blah… "alongside the Minutes of the following Monetary Policy Committee meeting." So the data comes out tomorrow, our meeting is Wednesday, the Minutes come out Thursday, so it gets concertinaed in.[2] So we will get a draft around as soon as we can. As soon as we write it.

Ben Broadbent. We have one ready for last month.

Governor Carney. Yes, exactly. We did anticipate this.

Silvana Tenreyro. You need to explain the video games.

Ben Broadbent. Sorry?

Silvana Tenreyro. You need to include the video games.

Governor Carney. The video game thing, yes. We will have to go down and do some research. Your son could help out.

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[1] Clarification added by the MPC Secretariat: Speaker meant to say "in the three months to July".

[2] Subsequent to the meeting, and following discussions with HMT, it was clarified that the letter would accompany the February MPC Minutes.

Ben Broadbent. He is doing it anyway.

Governor Carney. He is doing it anyway, so might as well leverage it. So, Andy, do you want to just do a quick stock take of what else we have learned.

> **Andrew Haldane.** Yes, I will be quick. Internationally, we had on Friday non-farm payrolls in the US up 228,000, slightly north of expectations, which were slightly below 200,000. On the other side of this equation, wage growth, however, remained weak in the US. Then domestically, we had last week the RICS Housing Market Survey for November, which had three month house price expectations turning negative - that's for the first time since 2013 – and bring that broadly in line with some of the indicators we have had from the Rightmove House Price Index. New buyer enquiries also negative, so the demand side weighing a bit there. And then finally, we had industrial production for October, which was flat on the month, with construction falling again sharply for the second month. Mechanically, that chips off more than 10 basis points from our Q4 GDP projection. The staff have aimed off somewhat on the grounds that construction, in particular, is subject to quite heavy revisions. Even ahead of the release our Q4 projection had been revised down to 0.3 on the back of the PMIs. This would nudge down that Q4 projection a bit further to about 0.27 – so on the cusp between 0.2 and 0.3. I think that's all. Thank you.

Governor Carney. Ok. Good. Any questions about that? Assuming none. We will start off with Ben and then Silvana.

> **Ben Broadbent:** Thank you, Governor.
>
> Let me first cover the international news. If that includes anything that happens physically beyond our shores, then perhaps the most important news this month is what happened in Brussels last week. But I'll begin with the data, which generally, again, has been pretty strong. The third-quarter growth was revised up in Japan, from 0.4% to 0.6%, and also in the US, from 0.7% to 0.8%. The hurricanes may have depressed final demand growth, which slipped to 0.6%, but strong stockbuilding added a couple of tenths to the figure. Recognising that this is unlikely to be repeated, we've revised down our forecast for US growth in Q4 from 0.7% to 0.6%.
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> We expect the reverse pattern – 0.6% in the third quarter, 0.7% in the fourth – in the euro area. And the slight acceleration would match the continuing strength of business surveys. Composite PMI has averaged 56.8 in the euro area in the first two months of Q4, after 56.0 in Q3. The ifo index hit another all-time high in November and there has also been a very marked rise in the last few months in the French Insee survey. It averaged +3[3] in the first half of the year, slightly above historical average. In October and November it was over 30, which is the highest readings since the summer of 2000.
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> Jon told us last week that 2017 is likely to be the first year since 2010 in which calendar year growth in China has risen. If we're right about the Q4 figure, calendar year growth in the Euro area would reach 2.3%, which is the strongest for a decade and certainly well above the 1.3% consensus forecast made at the start of the year. Even in June the average forecast was only 1.7%,[4] which required almost no growth in the second half of the year, as we observed at the time. So that upside surprise has contributed to a 12% rise in the euro/dollar exchange rate through the course of 2017. Together with economic strength elsewhere, it has also contributed to a very marked rise in equity prices, even if, as we were told at pre-MPC, prices of risky assets have slipped slightly in the past month.
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> In the US, some of that strength in equity prices reflects the long-promised passage of the tax bill. This reduces headline corporate tax rates and pares back the deductibility of debt interest, benefitting the most low-geared, high-margin companies such as Apple. Whether it raises investment remains to be seen; the positive effects on the federal deficit look clearer.
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> However, the more important deal, from our perspective, is the UK's exit agreement with the EU. This has been a long time coming, requiring significant movement on the part of the harder-line

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[3] Clarification added by the MPC Secretariat: Speaker meant to say "+7".

[4] Clarification added by the MPC Secretariat: Speaker meant to refer to the 1.4% consensus forecast at the start of the year, and the 1.8% average forecast in June.

fringes of the Cabinet, particularly regarding the UK's financial obligations. So there's precious little time left to negotiate any new trading arrangements. The agreement also includes some pretty fuzzy language about the Irish border. Quite how you can combine a frictionless border, no legal distinction between Northern Ireland and the rest of the country, and the UK's exit from the customs union and the single market isn't clear. So some claim the deal cements the fact of Brexit. Others say the only way to reconcile these three things is for the UK as a whole is to remain in "close regulatory alignment" with the EU. We shall see.

Whatever the likelihood and content of the final deal, and though it's taken a long time to get to, it is at least progress, not least because it brings with it the prospect of a relatively lengthy transition, during which nothing formal changes.

We will have to work out in the next forecast round what that might mean for our projections of demand and underlying supply. We've been conditioning, for a while, the forecasts on a "smooth Brexit", which we've taken to mean a transition period. But we've also assumed that the rules change in 2019 and that the most affected firms anticipate this more or less from now on. There are therefore associated effects on trade, investment and on productivity that kick in materially in 2018. And we may now wish to shift some of those back in time to 2019 or even beyond. Obviously it will be very important over the next few months to see how business sentiment responds, including in our own Decision Maker Panel, although we'll have only limited information on that front before the February round.

What we do know, in the meantime, is that sterling's exchange rate has appreciated in response. It is now close to 2% higher than the conditioning level in the last Inflation Report. Coupled with the further slight rise in the yield curve, this tightening in financial conditions more than offsets the impact on inflation of the slight loosening in the stance of fiscal policy, following the Budget. The barebones forecast update, which adds to the November projections only the fiscal impulse and the effects of changes in asset prices, has a central figure of 2.1% for inflation three years ahead, marginally below that in the last *Inflation Report*. And that assumes that we get the full 60% of pass-through from sterling's earlier declines into higher import prices. As you know, so far we've only had 50%.

The remaining domestic economic news this past month has, in my view, been limited. CPI inflation was 3.0% in October, unchanged from September, and 20 basis points lower than our forecast immediately beforehand. But as we've just heard, the figure for November was slightly above our forecast, at 3.1%. We'll have to take this through the new STIF projections, but as it stands we are expecting something close to this over the next two months, in December and January as well.

In the labour market, there was a striking decline in the participation rate in Q3 but, notwithstanding what we have just heard, this looks more like sampling noise to me than a true signal. If so, then the same is true of the 0.9% quarterly rise in hourly productivity. Q4 GDP growth, as Andy has reminded us, is tracking below the IR forecast of 0.4%. But it's still early days in the data cycle. We know not just that there are significant revisions to construction, but they are almost always upwards, and they account for more than half of the monthly revisions to aggregate output. And this should, in any case, be set against another downside surprise in the rate of unemployment in the third quarter. Surveys suggest continuing strength in hiring intentions and in labour market tightness. The Agents said their contacts expected this to be met with slightly higher pay awards in 2018. So wage growth was in line with our forecasts in Q3 and I see no reason to shy away from the acceleration in pay next year in the November *Report*.

So, for me, all that makes today's decision pretty straightforward. I see little reason to alter the stance of policy and expect to vote accordingly later this week.

I'll therefore just make a couple of points about communication.

First, I think we probably need to say something – even if it's only to "note" it – about the exit deal. We can promise to consider its consequences during the February forecast round, but it does, I think, need to make an appearance.

Second, the yield curve is evidently in a more sensible place, given the forecast, than it had been in September and before our rate rise. Whether it's quite enough to fit the remit, given the conditioning assumptions, is a matter for that forecast. But on the face of it, it seems to me we do not need to resurrect the language suggesting that our preferred path for interest rates is higher than the market's expectations. We may or may not want to remind people that those expectations involve another couple of rate hikes during the forecast period. But I'm not sure we need to go beyond that. And I'll leave it there.

Governor Carney. Thank you. Silvana and then Andy please.

Silvana Tenreyro. Thank you. The international data this month suggest that the strong world economy performance will continue into 2018. Global PMIs have remained elevated, especially in manufacturing. In the euro area, growth fell back slightly to 0.6% in Q3, but the Q4 survey data are suggesting a reacceleration. The picture is reversed in the US, where Q3 growth was revised up to 0.8%, but Q4 looks set to fall back a little following weaker consumption and trade data in October. In Asia, Japan grew strongly again in the third quarter and although Chinese indicators suggest some slowing, the data have been broadly in line with our expectations.

Geopolitical risks in Asia and Europe have not gone away. Political uncertainty in Germany and recent developments around Israel have added to the list of risk factors to monitor. A Chinese hard landing remains a concern, mostly due to the effect it could have on global activity, rather than a direct effect on the UK economy through financial exposure or bilateral trade links.

On the upside, a more gradual pace of policy tightening in advanced economies may be able to prolong the current growth momentum for longer than we expect. Core inflation remains low in the US and especially the euro area; and country-level unemployment figures in the euro area suggest that there is still significant slack in the economy. In the US, the probability of fiscal stimulus actually being enacted has increased. Strictly speaking, this amount to a removal of downside risks to fiscal stimulus, rather than upside risks.

Turning to domestic demand, the data news is consistent with subdued growth in the near term. For the fourth quarter, the surveys and data so far suggest growth of around 0.3%.

Further out, there should be some boost to aggregate demand from the moderate fiscal stimulus announced in the Budget. Taking the expenditure split at face value, consumption growth was stronger than expected. But the forward-looking picture does not look as positive: new car registrations fell in October and most UK housing-market indicators have weakened. The number of approvals for house purchase fell in October for the fourth month in a row. The Nationwide and Rightmove measures of house price inflation slowed slightly in November, consistent with recent weakness in the RICS survey. The Halifax measure is much stronger, though I learnt this is typically the most volatile of our indicators.

The drag from net exports is likely to be erratic, given recent strength in export growth and manufacturing goods orders. The Brexit deal struck last week seems to have been taken well by markets, but there remain risks to our investment and trade forecast depending on how the second phase of the Brexit negotiations evolve.

There was a mixed picture from the latest labour market data. Employment growth in Q3 was flat and average hours fell. Since the participation rate also fell unexpectedly due to the greater number of students, the unemployment rate fell once more, although still at 4.3% to one decimal place. Updated forecasts were for it to reach a low of 4% in Q1. The bigger-than-expected fall in hours also means that hourly labour productivity grew by a healthier 0.9% on the quarter in Q3. Even if productivity were flat in Q4, its four-quarter growth rate would still finish the year 0.2pp above our November forecast. The monthly data for October is roughly consistent with this picture.

There was little news in underlying wage growth in the latest data. Although there was some bonus-driven news in total pay, private-sector regular pay growth came in broadly as expected in September and October.

Our usual LFS-based estimate suggests that compositional effects are pulling down on annual wage growth by around half a percentage point in Q3. The effect comes mainly from a greater share of workers with lower qualifications. Interestingly, the new staff measure of median growth in wages from ASHE tells a different story from the LFS over the past, but it also suggests compositional effects were pulling down on wages by around ½ percentage point in the year to April 2017. If we think there are similar effects on productivity, however, then ‘adjusted’ productivity growth would be similarly higher, leaving unit labour cost growth unaffected. Annual unit labour cost growth fell from 2.3% in Q2 to 1.5% in Q3, mostly driven by past increases in non-wage costs dropping out as expected; though productivity growth also played a role.

Separately, the latest migration figures showed a fall in net migration in the year to Q2, particularly from the European Union. This could represent a downside risk to labour supply, even further than will be embodied in our next forecast. The skill composition of migrants together with complementarities in production might have an additional effect on future productivity growth.

Inflation surprised us on the downside in October, staying at 3.0%. November came out just slightly above our expectation. While there will be some near-term upside news from the tax changes in the Budget, the net effect is likely to reduce inflation from April 2018. Oil prices are a little higher on the month, but there has been little lasting news on the impact of sterling on CPI. The staff estimate of exchange-rate pass through picked up a little in the latest data, and the impact on inflation is broadly on track. But the overall effect of the exchange-rate pass through on the level of CPI is still below our forecast assumptions. This may mean that the inflation impact could dissipate more quickly than expected.

Stripping out external influences, DGI measures have fallen in the latest data. All measures remain below target-consistent rates: by around 1 percentage point for the labour cost and GDP deflator-based measures; and by 0.2 percentage points to 0.6 percentage points for the consumer price measures. Inflation expectations are all in line with our own inflation forecast.

Pushing in the other direction is, as I said before, the possibility of a labour supply effect from falls in net migration, together with the associated productivity losses. The size of this effect is, however, unclear – we need to do this calculation.

It is possible to make arguments in favour of a further rate rise over the next few months. Conditional on the November forecast, the staff optimal policy simulations with low interest-rate smoothing had suggested one further rate rise by mid 2018.

But the inflation and output gap outcomes were almost identical in the staff’s high smoothing simulations. Those simulations suggest a more gradual path, with no further increase until around the time of Brexit. Given the uncertainty around the Brexit negotiations and about the supply side of the economy, I view advantages to the more gradual path.

In terms of communications and forward guidance, I think we need to be prepared for the growing demand for guidance. There are pros and cons to publishing a path, but the global demand seems to be going in only one direction.

I am not in favour of individual plots. They require individual forecasts, as any hypothetical rate movement will trigger a change in the forecast. And any forecast, in turn, would be affected by how each member expects others to vote on QE and Bank Rate. This is a nightmare fixed-point problem. A best collective judgment seems more appealing to me.

Turning to the vote, I think the current stance is appropriate and I intend to vote for no change in rate or the stock of asset purchases.

Governor Carney. Thank you very much Silvana. So Andy, and then Dave please.

Andrew Haldane. Thank you Governor. I want to say something about reactions to last month’s rate rise and then, more briefly, cover how the outlook has changed since then.

Looked at in the round, and although still early days, I think there are good reasons to be reasonably content with how the first rate rise in a decade has landed with businesses and households.

There are no signs, from the surveys of either, of confidence having been dented by the rate rise. Nor are there any signs of any out-sized response in spending by companies and consumers.

Indeed, the Bank’s latest Inflation Attitudes Survey, the results of which were taken in the days immediately after the Inflation Report, has seen the largest increase in reported net satisfaction with the Bank's actions since the start of 2014. It is difficult to know how much, if any, of this increase was the result of the November rate rise. But this survey has consistently suggested that, when faced with a trade-off between higher prices in the shops and higher interest rates, households tend to dislike less the second (higher rates) than the first (higher prices). This means that, if the November IR helped convince households that higher rates were necessary to counter rising inflation, it will have tended to boost households' satisfaction with the MPC's actions, as we observed in practice.

Surveys also suggest that households appear largely to have understood the MPC's messaging in November about the likelihood of further rate rises. The latest Markit Household Finance Index suggests that more than half of households now expect an increase in Bank Rate within the next six months and more than three-quarters by the end of 2018. By way comparison, around half of economists in the latest Reuters poll expect Bank Rate to have increased by the end of 2018. So overall, I think it is mildly reassuring that households are factoring further rate rises into their plans, since this will tend to reduce the chances of them facing policy surprises down the line.

How much of this realignment in households' rate expectations is the result of the MPC's simpler, layered communications is hard to say definitively. It is perhaps worth noting, however, that downloads of the November IR were around twice those of previous Reports, with this increased traffic almost entirely accounted for by Layers 1 and 2. This is consistent, at least, with our communications having reached a somewhat broader audience than in the past.

As for financial markets, it is fair to say the response from City commentators and economists to the MPC's November decision was more lukewarm Having dug into this a little, these grumbles appear to have two sources. In one camp were those who simply had a different view of the economy, typically thinking it would be weaker and/or that any pre-Brexit move in rates was likely to prove premature. This different view of the future may or may not come to pass. But either way, it is a difference of view on the economy, not a criticism of the MPC's messaging per se.

A second camp did complain the MPC's messaging this year had been mixed and/or had lacked clarity. But, as Ben pointed out at the deliberation meeting, lying beneath this criticism often seems to have been a desire for the sort of unconditional, time-specific policy guidance that is best avoided at all costs.

Suffice to say, having invested some time myself in understanding these expert criticisms of the MPC's November actions I will, like many British businesses at the moment, be more cautious about making this investment in future. And in any case, the facts of the matter are this: the path of OIS rates over the next two or three years are pretty much identical today to the 15-day average assumed in the *Inflation Report*, which is precisely the outcome the MPC had aimed for pre-publication.

Turning more briefly to the news on the economy since the *Inflation Report*, the two most significant pieces have been, first, the Budget and, second the on-going Brexit negotiations. Outside of those two events, UK macro news has been relatively modest in its overall impact on our GDP and inflation projections. Although the latest labour market and housing data do bear some further reflection.

On the Budget, our usual approach puts the combined impact of the new fiscal measures at around 0.3% on the level of GDP, and 0.1 percentage points on inflation, at the policy horizon. These are reasonably material changes. And, taken together with the OBR's revised productivity assumptions, they also make for a materially flatter profile for one of the measures of the fiscal stance we typically use – namely the cyclically-adjusted primary balance.

As Richard showed at the deliberation meeting, the slope of this line – while still upward, consistent with a continuing fiscal drag – has flattened significantly, from around 0.6 percentage points of GDP per year from 2018 to 2020 back in March, to around 0.2 percentage points per year in the latest Budget. Overall, I think this degree of fiscal loosening is good news, not just for the economy, but also for the mix of monetary and fiscal policy supporting it. Put differently, the fiscal loosening in the Budget ought to make the transition to a less accommodative monetary stance over the next few years, should that come to pass, somewhat easier.

It is early days, but the most recent news on Brexit negotiations may also nudge in that direction. The data from our Decision-Maker panel is clear that a significant minority of companies – perhaps around 40% – have held back on investment as a result of Brexit uncertainties. This has had a depressing effect on aggregate nominal investment growth of perhaps around 3 to 4 percentage points in the first half of this year with a further, if smaller, headwind expected next year.

If the recent Brussels agreement does indeed pave the way for a lengthier and/or more orderly transition than companies had been expecting, this would damp near-term uncertainties and increase the chances of investment surprising to the upside in the period ahead. For now, however, it is simply too soon to tell. As Ben said, our Decision Maker Panel will be important in gauging whether recent Brexit events have moved the dial investment-wise.

Bringing all of this together, then, my assessment of the UK economy – growth still pretty resilient and with a slow build in nominal pressures – is not much altered since the *Inflation Report*.

But, if anything, the combination of the muted response so far by households and companies to the MPC's rate rise, in spending and confidence terms; the looser fiscal stance; and the potential lowering of near-term Brexit uncertainties, may have brought forward, just a touch, my assessment of the appropriate timing for reducing further the degree of monetary policy accommodation.

But that timing is not now. So I intend later this week to vote to leave unchanged both Bank Rate and the stock of asset purchases. Thank you.

Governor Carney. Thank you Andy. So Dave, and then Ian please.

Dave Ramsden. Thanks Governor. During our policy meeting last month I set out my assessment of the economy. And, although I am fully signed up to our framework for setting monetary policy, my interpretation of the data was a little different from the majority of the Committee. Specifically, I put some weight on the idea that workers have been showing greater flexibility in their wage demands in response to the changing outlook, which would mean there is a little more room than headline measures of slack suggest for the economy to grow without generating above target inflation in the medium term.

Whichever way one voted, after November's decision to increase Bank Rate for the first time in a decade one might have thought that the MPC would have been entitled to a quiet month. In fact, I think there has been quite a lot to digest. I'd like to use my statement today to set out how those developments have affected my assessment. And while my underlying view has not fundamentally altered, the news since our previous meeting has contained plenty to highlight two-sided risks to the UK outlook. And I note up front that developments continue, with the exchange rate in particular remaining sensitive to news on the agreement between the UK and rest of the EU on the terms of our exit, with the recent increase in sterling contributing to a tightening of financial conditions relative to the November *Inflation Report*.

But let me start with a few words on the transmission of the change in Bank Rate, which has been overall reassuring. Money markets adjusted as you would have expected – the unsecured and secured overnight benchmark rates (SONIA and RONIA) have been on average 25 basis points and 26 basis points higher respectively in the intervening period relative to the prior month. A little further out, the initial reaction of the yield curve – in the response to the removal of our comment that monetary policy could need to be tightened to a somewhat greater extent than market expectations – seemed overdone. But over the period as a whole movements in the yield curve suggest that market participants have understood the change in Bank Rate as consistent with our demand, supply and exchange rate framework. And any communication by us this month should seek to reinforce this message.

As we discussed on Wednesday, the transmission of these changes in risk free rates to borrowing and lending in the real economy seems consistent with historical experience. Pass through to lending rates has been broadly in line with our expectations. Pass through to deposit rates does not seem inconsistent with historical experience. Moreover, the survey evidence of households' reactions to the change in Bank Rate is encouraging. As Andy has just highlighted, 80% of households expect that Bank Rate will rise over the coming year, consistent with financial market expectations. And intelligence from the Agents suggests the increase in Bank Rate was largely expected by business contacts right across the country, and that increases in Bank Rate over the next two years would be modest.

Let me turn next to demand news. Growth certainly seems to be on a firmer footing now than it was at the same stage in the data cycle three months ago at our September meetings, when the early expenditure breakdown for Q2 suggested that private final demand had subtracted 0.2% from GDP growth. Taking the early Q3 data at face value, together with more recent indicators of consumption, point to continued underlying momentum in the economy. Set against that, some survey indicators suggest a modest weakening of activity into Q4 and then Q1, and the October Index of Production and Construction data released on Friday may be the first signs of that coming to pass, or just even more evidence of the volatility of early prints of the ONS data. Looking a bit further ahead, the main news for the demand outlook came in the form of the Budget, with higher departmental spending and a modest net tax reduction likely to boost the level of GDP by 0.3% over the forecast horizon and contributing to a material change in the path of the cyclical adjusted primary balance.

Let me turn next to supply, where the labour market quantities data gave mixed signals. On the positive side, 0.9% growth in productivity in Q3 was the strongest in 6 years. On the face of it that is evidence in support of there being a sizeable degree of spare capacity within firms. But less encouragingly, inactivity grew by 151,000, the largest quarterly increase since 1971, as Ben pointed out. This increase in inactivity was sufficient to see the unemployment rate fall, despite employment itself actually declining. The reality is, however, that neither the productivity or the participation data for one quarter should be over-interpreted, particularly in light of the low response rates of the Labour Force Survey.

Ben has just highlighted the potential implications of the exit deal for our forecast judgements. There are two other developments on the supply side that merit mentioning, both of which have made me at the margin more concerned about the speed limit of the economy over the forecast horizon.

The first is the fall in net migration, which fell by 106,000 over the year to 2017 Q2 driven by a fall in net migration of EU citizens. This was only a bit below the ONS's principal case, meaning it doesn't represent material news to our own forecast. But the trajectory does raise the possibility that migration may continue to fall sharply, with implications for the quantity and quality of growth as Silvana has just drawn attention to.

And the second is the OBR's revision to their trend productivity forecast. Their downward revision from an average growth rate of 1.6% to 0.9% per year over the next three years has, in one swoop, brought them from having a forecast somewhat above ours to one that is somewhat below. While I have no reason to think that the OBR's forecast is any better than our own, both still look strong by post-crisis standards, when actual annual productivity growth has averaged 0.5%.

The news on the Brexit deal, actual productivity, participation, migration, and the OBR's revisions, have certainly whetted my appetite for the upcoming supply stocktake. But I haven't yet seen sufficient evidence to materially alter my view that there is a little more room than headline measures of slack suggest for the economy to grow without generating above-target inflation in the medium term. The inflation data saw a downside surprise for October, and then a smaller upside surprise for November. But the earnings data continued to suggest that labour costs are still running below rates that would be consistent with domestic cost growth being strong enough to support inflation at target in the medium term.

That said, I believe there is a strong case for not changing Bank Rate at this meeting. We have done much to promote and improve the understanding of our reaction function, in particular emphasising the role of demand, supply and the exchange rate for framing the outlook the outlook for inflation. And I believe this has contributed to the smooth transmission of the first increase in Bank Rate in over a decade, including measured responses from financial markets, banks, households and businesses. To be consistent with the framework we have laid out, and thus to avoid a costly loss of credibility, I would think a material change to the outlook for supply, demand or inflation would be required to reverse the increase in Bank Rate so soon after it was implemented. And for me that bar hasn't been met.

So, for this month, I intend to vote for no change in Bank Rate from its current level of 0.5%. And no change in the stock of asset purchases.

Governor Carney. Good. Thank you Dave. So Ian and then Michael, please.

Ian McCafferty. Thank you. Good morning everyone.

Reassuringly the news flow provides little to question last month's decision, or the underlying policy strategy we have been pursuing. With the first stage Brexit deal finally concluded on Friday, things look set fair for a calm consideration of the supply stocktake and the February forecast.

On the demand side, things look closely on track. At a global level, the narrative of a strengthening, co-ordinated global upswing continues to be underlined by the data, with two global activity indicators – the ifo World Economic Climate indicator and the JPMorgan global manufacturing PMI – hitting six-year highs in their latest releases. Regionally, the Eurozone continues to grow robustly, with surveys perhaps slightly above expectations; the US continues firm, and growth in China appears to have stabilised at 6.5% to 7%, underpinned by the government policy stance.

Against this background, and with the news of an extension of the OPEC/Russian agreement to restrict production until the end of 2018, crude oil prices have risen by 7% since the November *Inflation Report*. However, I strongly support the staff analysis suggesting that oil prices will remain range-bound for the foreseeable future, constrained by the persistent inventory overhang and the potential supply responsiveness of shale oil in the US. Any commodity-inspired global inflation risk therefore needs to be sought elsewhere. And there, the evidence is mixed. Prices of food and agricultural commodities have been generally softer over the second half of 2017, but metals prices have risen by 15% since the summer, driven by Chinese government policy and other supply disruption. Some more analysis of this source of potential inflationary pressure would therefore be helpful as part of the February forecast round.

Within the UK, demand and output still look broadly in line with the November forecast. Our demand rotation story is being tested by the initial expenditure data, but the potential for revision to both business investment and net exports makes it too early for any strong conclusions. The same is true for the latest construction data, which at face value provide further downside to the staff nowcast for Q4 GDP. But, at a more fundamental level, the slight relaxation of fiscal constraints announced in the Budget, combined with the probable impact of the Brexit news on confidence, is modestly expansionary. Although these are somewhat offset by recent exchange rate news.

The news on the domestic supply side, and on inflation, is slightly less clear cut. In the labour market, the information in the disaggregated data suggest that the small and slightly puzzling moves in employment and inactivity are likely to be noise, while the stronger signal appears to come from the further fall in unemployment, the slowdown in migration and the Agents' evidence of intensifying skill shortages and hiring pressures, which are now at their highest since scoring started in 2005. All these testify to an increasingly tight labour market.

This is still not fully supported by the wage data, but the more reasons we unearth for reasons for weakish wages other than simply the existence of slack, the less the incongruity. As staff have shown, the composition effect is still dragging on wage growth, and the new analysis demonstrating the wider differential in pay between "job stayers" and "job movers", presumably as a result of the gradual atomisation of the private sector workforce and the decline in collective bargaining, will be doing the same. These are both arguments more for a downward shift in the Phillips curve than for its disappearance. And with job churn now returning to pre-crisis levels, and the Agents latest evidence of rising settlement expectations into 2018, our expectations of rising wage pressures to come still look reasonable.

With all of these factors in play, I am looking forward to the supply stock take next month. But without prejudging the outcome, I am not convinced that a lower U* would change my judgement of the size of the effective output gap. In trying to reconcile our bottom up decomposition of the current output gap estimate with top down filter methods, we have been offsetting our uncertainties about the labour market with ever lower capacity utilisation. Our current decomposition gives a utilisation gap of close to 1% of potential output, that's higher than in 2010-11, even though survey evidence suggests utilisation levels above normal in manufacturing and close to normal in services. As a result, even if we were to lower U*, this should be offset by a recalibration of our capacity estimate, such that the net change to our output gap is likely to be negligible.

On the inflation front, the November CPI pre-release supports my hunch that it is too early to lock in the downside news from the October CPI data. The services PMI data, is still showing persistent strong pressure on services input prices and, importantly, a sharp acceleration in output price pressures in November. More broadly, I think it still too early to conclude that a) first stage pass through is less than we assumed, rather than simply slower, or that b) second stage pass through has now comprehensively peaked. There is anecdotal evidence that pass through along supply chains has been initially hesitant, especially in the food sector, such that we may yet see a more sustained period of CPI inflation close to 3% than we currently assume.

If these observations and reflections were to be mechanically incorporated into our forecast, we would have possibly fractionally stronger growth, a slight upside to our inflation trajectory, and slightly less of a trade-off. As yet, though, these are insufficient to cause any concern about the current expected policy path. Not least because the Brexit deal has strengthened sterling. The conditioning path we used in November, which implied two more gradual rate rises over the policy horizon, still seems reasonable.

But if I were to fashion a skew around that conditioning path, I suspect that, absent Brexit-related or other disruptions to the forecast, we might end up tightening fractionally more, rather than fractionally less, than the curve currently implies. And that does have some implications for the tone of our communications in coming months.

In general, I have been reassured by the different reactions to last month's decision. The forward OIS curve remains close to that conditioning the November IR, suggesting that earlier misnomers about our reluctance to raise rates during Brexit uncertainty have been dispelled. Importantly, households have also got the message, at least according to the TNS survey. Nor have we seen negative behavioural reactions to the first rate rise in 10 years – the Agents reported a positive Black Friday and reasonable expectations of Christmas spending.

But if a message is worth saying, it is worth saying twice. So I would be keen for us to repeat the messages of last month – "gradual and limited path, with a couple more rate rises to be expected over the next two to three years" in this month's MPS. That level of guidance, I find, is invaluable to businesses and households, who are happier with that degree of fuzziness than are the markets.

But in terms of more explicit and precise guidance, I am more reticent. Markets – and politicians – always want more openness and more precision. Markets have a lot of precisely-positioned skin in the game, and as some of the comments at last week's Monetary Policy roundtable showed, would love us to make life even easier for them.

But, unlike a few years ago, where we resisted saying anything meaningful about interest rates beyond the immediate policy decision, I believe that these days we are close to the limits of reasonable precision in what we say, given the inherent uncertainty in the economy. This is even more so in a national climate that interprets any conditional statement as having absolute precision and certainty. And, the more precise our guidance, the more we may end up assuming the moral hazard of financial decision making for others, who may treat our communications as more certain than we intend, and then blame us when circumstances change.

Any further shift in the level of our guidance is a one way street – once we start, there is no going back. So, while it would be intellectually fascinating to explore the communications value of dot plots, our own conditioning assumptions or optimal policy paths, I believe we need to treat any external exposure of these with a healthy degree of caution, or risk a series of threats to our credibility, and hence the effectiveness of our policy-making.

The advantage of a meeting such as today's, within weeks of a rate change and when the data news has been relatively light, is that it allows such reflections on issues less central to the immediate policy decision. For this month, I am minded to maintain our current policy stance, meaning no change in Bank Rate or in the level of purchased assets.

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

Michael Saunders. Thank you Governor. I am inclined to vote for no change in rates or the stock of assets this month.

Much of the economic outlook is pretty similar to last time.

Business surveys still suggest that the economy is likely to grow steadily at 1½% - 2% year-to-year. Consumer spending is fairly sluggish, exports are buoyant and investment is in between. Anticipation of Brexit is probably already having a significant adverse effect on consumer spending, housing and business investment. But activity is also likely to be supported by various positives, including buoyant global growth and the relatively loose monetary policy stance. Fiscal drag in the next two years is likely to be considerably less than previously expected. Overall, the economic outlook is not great, but is not terrible either.

Consistent with this, surveys suggest that firms' hiring intentions are around their longrun average, and a little stronger than a year ago.

There has been little news either way on the level of spare capacity. I suspect that the output gap is very small, if not already closed. The jobless rate continues to drift down, under-employment is lower than a year ago and there is not really evidence of significant spare capacity in firms. Surveys suggest that skill shortages have worsened and, averaged across a range of survey guides, are similar to the pre-crisis peaks.

It remains likely that CPI inflation will edge lower in early 2018. Domestic cost pressures are unlikely to weaken, but the boost to CPI inflation from sterling's depreciation is probably now around its peak and likely to gradually diminish.

One issue that I would like to highlight is that our forecasts may understate the extent to which Brexit is likely to reduce labour supply. Indeed, this is already happening.

Workforce growth is down from 0.9% year-to-year a year ago to 0.3% now; that is the weakest since early 2012. The workforce has not grown at all over the last two quarters combined, for the first time since 2010. The key factor behind this is that the contribution to workforce growth from people born in other EU countries has fallen close to zero. By contrast, over the prior four years, UK workforce growth averaged 0.7 to 0.8% year-to-year, and that growth entirely reflected a contribution from foreign workers, especially from other EU countries. The contribution to the workforce from people born in the UK has been zero for a while, with a rising trend in participation offset by population ageing.

The drop in foreign worker inflows is, of course, likely to weaken demand in the economy as well as supply. Foreign workers are consumers. But this should be already incorporated in the various activity guides that we track. The signs are that the economy is growing steadily, despite this factor.

The slowdown in labour supply implies that potential growth may even be below our 1½% estimate. This estimate is already well below the pre-crisis norm of about 2½%, reflecting lower productivity growth. But UK potential growth has actually been supported in recent years by that migration-induced expansion of labour supply, which kept workforce growth close to the pre-crisis average despite adverse demographics. In the US and Euro area, by contrast, workforce growth has slowed in recent years and has been well below the UK pace.

For example, most estimates put euro area potential growth at around 1%. The UK and euro area have had similarly low rates of productivity growth in recent years. But, euro area workforce growth averaged just 0.4% per year over the last four years, half the UK pace. The difference in workforce growth entirely reflects the higher pace of foreign worker inflows to the UK over those years. Take this away and, unless UK productivity growth rises markedly, UK potential growth may be similar to the meagre euro area pace. Or, putting it differently, the jobless rate may well keep trending down even if economic growth remains around its recent pace of roughly 1½% year-to-year.

Overall, unless the economy weakens significantly, I suspect the labour market will tighten further, with the jobless rate falling to, and then probably below, 4% during 2018 alongside declines in under employment. In turn, skill shortages are likely to worsen further and, even allowing for heightened labour market flexibility, pay growth is likely to pick up meaningfully in 2018. This points to risks that rising domestic cost pressures will keep inflation above target over time, even once the direct inflation boost from sterling's depreciation fades.

If things unfold along these lines, then interest rates probably will need to rise further over time and perhaps by a bit more than markets price in. But I see no need to act now, this month. We can allow the recent rate hike to settle, to see a bit more economic data and to see how Brexit developments evolve.

The other issue I would like to discuss is our communication on interest rate prospects.

In the November IR we forecast that the market rate path would leave inflation close to – but slightly above – target. The MPS repeated our formula that “any future increases in interest rates would be at a gradual pace and to a limited extent.”

But the MPS did not clearly say whether, if the economy broadly follows our forecast, interest rates would be likely to rise further over time or not. The prospect of further tightening was suggested in the press conference, but was not said explicitly in the MPS.

The ability of outside observers to interpret interest rate signals from our forecasts is much harder given we are in the exceptional circumstances part of the remit and seeking a reasonable trade-off between slack and inflation. Outside observers do not know our spare capacity estimate, nor what trade-off we consider to be reasonable. A forecast that inflation will be slightly above target over time with market rates could be interpreted as either hawkish or dovish depending on these other factors. In my view, we cannot at present assume that an implicit message on interest rates will be interpreted as we would like.

I think this led to some confusion over our message. In the end, the message that rates probably will rise further over time if the economy roughly follows our forecast had to be spelled out over subsequent days.

So I would like us to provide slightly clearer guidance. My preference is for this month’s MPS to clearly state that, if the economy evolves roughly in line with our forecast, then interest rates probably will rise further over time, in a limited and gradual fashion. Of course, any such statement has to be heavily caveated regarding uncertainties over the economic outlook and Brexit developments. At times, we may want to say that – conditional on the forecast – we expect rates to rise more or less than markets price in. But even if we have no such bias at present, I think it is useful, especially for households and businesses, to provide a steer over the likely general direction of interest rates. Thank you.

Governor Carney. Thank you Michael. So Jon and then Jan, please.

Jon Cunliffe. Thank you very much. This morning I will talk briefly about how the economy has evolved relative to my expectations as of the November *Inflation Report*. But I also wanted to look at how the likely deal with the European Council and the next stage of Brexit negotiations might affect relative paths of supply, demand and the exchange rate.

On this month’s news the second estimate of Q3 GDP was in line with the 0.4% in the November *Inflation Report*. That release included the initial expenditure breakdown for Q3. The surprising strength of consumption growth – 0.6% on a quarter ago compared to the 0.3% we had forecast in the IR – suggests a bit less of the rotation that has been our narrative. The flipside of that – less strength in trade and business investment – raises for me just a little concern about the sustainability of current growth.

The second release also updated the output breakdown. There the narrative remains intact – strength in production, somewhat weaker in services and quite marked weakness in construction. CBI and PMI surveys remain weak for services and the first output data for Q4 were disappointing, so staff have now downgraded the Q4 nowcast to 0.3%.

Beyond the GDP figures, remaining data releases since November suggest we are broadly on track with the forecast. I have previously highlighted my caution on the strength in our wage growth forecast. But that strength doesn’t really emerge in the forecast until the second half of next year. So the recent wage out-turns (for September) – 2.2% growth for both total and regular pay – and the news heard this morning were broadly as expected, and don’t for me provide news.

Staff showed us analysis suggesting that the sluggishness in wage growth largely relates to those who remain with the same employer. The impact of churn may be having a direct effect – wages rising for those who move job – but not the indirect effect of how that is reflected in wider wage settlements. The agents have previously identified a perception among firms that they can tolerate greater inequity of pay between new recruits and existing workers now than was possible in the past. That may be reflective of long-lasting structural changes in how wages are set or it may just reflect a lag and we'll have to see.

The tone of the Agents was somewhat stronger than in the recent past – that firms are reporting they expect higher wage settlements next year – so it will be instructive to see whether this gets reflected with in-job pay rises picking up. We will learn more from the Agents' pay survey, which is currently in the field.

In terms of quantities, the currently low and falling unemployment rate has been accompanied by a fall in employment – the two reconciled by a marked rise in inactivity of over 150,000.   This is a puzzling combination and, as such, I think for the moment, as Ben suggested, we are best treating it as a blip.

The other recent data that point to less labour supply than we might expect given current conditions were the ONS migration figures. These showed a material fall in net inward migration from the EU over the year following the referendum. Much of that will be the economic impact of the depreciation of sterling and the poorer economic prospects in the UK relative to the rest of the European Union. But some may be the result of potential migrants perceiving an anti-migration message in the vote and in subsequent political statements. That may be a temporary effect given some softening in the government's position on migration and the probability of a transition period. The estimated impact of changes in migration on inflation is assessed to be small – migrants add to both demand and to supply.

Turning to the rest of the world. The world economy continues to look strong – with 0.7% growth forecast for Q4 in both the US and the euro-area. A boost is expected from US tax reform, which has been passing through congress in recent weeks. That package is worth in the order of 0.7% of US GDP, but that appears to be pretty much in line with what we already had in the forecast.

My policy position is centred on the evolution of domestically generated inflation but that is not to dismiss imported inflation which remains important for its impact on headline inflation and hence the trade-off. While second stage pass through has progressed broadly in line with our judgment, the impact on import prices remains some way behind the judgment and that has been true for quite some time now. This is something I think we need to explore in more detail in the February forecast.

Turning to Brexit, if there is a deal, as expected at the European Council later this week, we will move into the next stage of Brexit negotiations, which will turn to the details of a transition period of around two years after the UK has left the EU and to our future relationship with the EU.

The agreement reached in principle on transition does not lock it in. The details will take time to agree before they can be included in a draft separation treaty probably in the second half of next year. And the treaty and associated legislation will probably not be ratified until the first quarter of 2019. But the risk of a cliff-edge Brexit in 2019 has receded very materially and now becomes more one of execution risk.

The Brexit negotiations now also move onto trade talks. The UK government will, I think, need soon to lay out clearly whether they want a trade agreement or something closer to the EEA. That may change the average for the end state that we currently have in our forecast. Moreover, trade talks are likely to have a different dynamic to the negotiations so far, with fewer big 'events' such as agreeing the divorce bill, or the principles of the Irish border. There will still be crunch points – mainly around European Councils – but I think the trade talks will be a slower burn process.

In this state of the world, I think households will probably continue as they have to date – with relatively little discernible impact from Brexit on how they perceive the future or perhaps even with a little more optimism.

For businesses, especially export facing businesses, the impact may well be felt sooner. Transition may allow them to delay hard choices on investment. But on the other hand, as soon as they start to see clarity on the future arrangement the government is seeking, they will have a clearer end point to which they can plan, which may affect investment.

For markets, I think there is something for us to learn. As we saw in the staff presentation, volatility in the sterling exchange rate has been clearly linked to news from the negotiations. But the magnitude of that volatility hasn't been any larger than previous 'regimes' as staff showed us last week. We have discussed the extent to which cliff-edge is priced into markets – that is, what impact the potential different paths to Brexit are having on the exchange rate – but it may be that it is the perception of the end-point that has really been holding sterling in its current range. As such, news on that eventual relationship which emerges through trade negotiations could have a sizeable impact on the exchange rate.

All in all, I think the possibility is quite high that the divergence of expectation about Brexit between markets and households will continue. If anything, it might increase if markets react adversely to news about the end point while households see this as too distant to impact their behaviour. And although the transition will give businesses more time to adjust, news on the government's desired end point might mean that we start to see faster adjustments to investment and the supply side.

So in conclusion, the news on the UK and world economy since the November *Inflation Report* has not changed my overall view. I continue to think that the evolution of domestically generated inflation is the key to the appropriate monetary policy stance and I have not seen anything to change my view of that.

It will be some way into 2018 before we know if the labour market is evolving in line with the assumptions in our forecast. This was central to my decision last month and remains for me key for the path of future policy. On Brexit we are probably in for more of the same divergence of expectations, which could drive further inflationary pressures over the forecast period. But that for me remains to be seen. In the light of the news to date, I am minded to vote for no change in policy.

Governor Carney. Great. Jan, please.

Gertjan Vlieghe. Thank you. This month's decision is straightforward. I am minded to leave policy unchanged.

I will discuss three things today. First, my quick take on the data and the news since our November meeting. Second, the market reaction to our November decision. Third, some reflections on the path of policy in the next few years.

My interpretation of the news since our November meeting is that the current quarter looks set to be a little weaker, but global growth remains strong and the fiscal news is upside news to the subsequent years. The recent output data points to a Q4 GDP print of a thin 0.3%, against the 0.4% we were expecting in our November forecast. A lot of that downside news is driven by weak construction data, which is of a notoriously bad quality. But it does tend to be informative for the preliminary GDP release, and get revised only later in the process. Moving away from the monthly output data, it is not clear that we have had significant news on growth momentum in either direction.

Consumption growth looks like it will ease back a little in Q4, with retail sales making a smaller contribution than in the previous quarter, and car registrations falling back in Q4, after a small bounce in the previous quarter. The housing market, which showed some tentative signs of life in the summer, seems to be fading again. But our November forecast only pencilled in 0.2% consumption growth for Q4, which is markedly slower than the 0.6% outturn for Q3. The business activity surveys, export-related surveys and investment intentions surveys provide little news relative to our forecast, so far. Other than in one important respect: the risk that, at some stage, insufficient progress on Brexit will cause businesses to lose patience and therefore lose confidence shows no sign of materialising.

On the prices side, pay growth looks on track to move closer to 3% by February or March 2018. If that happens, I suspect there will be a lot less pushback against our assessment that we are seeing some tentative evidence of labour market tightness leading to upward wage pressure. So far, I am not concerned by the weakness in recent months of actual employment growth, which is very volatile. Rather, I take comfort from the strength of employment-related surveys and surveys that relate to tightness of the labour market directly. Regarding CPI, we have been saying for a year now that it would reach around 3% in late 2017, before easing back. That's where are now – a forecasting success. And the easing off in higher-frequency inflation momentum supports our structural, pass-through-based forecast that we are close to the peak in CPI inflation.

The fiscal news we have had since November has been unambiguously positive for the near term. We have gone from planned structural deficit reductions of -1.7% of GDP in the next three years to now only a planned reduction of -0.6% of GDP, a 1.1pp loosening. On a measures basis, the government is taxing less and spending more to the tune of 0.5% of GDP at the highest point in 2019, although it does tail off in 2020. That seems sizeable to me. There is uncertainty about the multipliers, and the dynamic effects, but it seems there is upside risk to the initial assessment of a 0.3 percentage point impact on the level of GDP.

In sum, the data suggests our November forecast is broadly on track, and the fiscal news seems like upside news. Taken together, that would require some combination of a higher path of interest rates and a higher level of the exchange rate.

Next, let me turn to the market reaction to the November decision. We broadly aimed to steer a communications course between "one and done" and "the start of a regular hiking cycle". That is where we ended up, and, given that it was the first hike in 10 years, that counts as a modest success in my book. It is true that interest rate expectations moved down 10 basis points on the announcement, to the great excitement of the FT, but seen as rather less exciting by many market participants. The reason this 10 basis point move down was not that exciting, is that it merely unwound the 10 basis point move in the previous week as market participants positioned for a more hawkish report. The positioning for a more hawkish report is something we only know with hindsight, but it is a useful reminder of how difficult it is to assess positioning before the event. The bigger picture is that the market is still pricing two further hikes by the end of the forecast period, little changed from the conditioning path in the *Inflation Report*.

One area of communication that does leave room for improvement is the way we talk about the trade-off. In our November communications we dropped the sentence "could be tightened by a greater extent" that we first introduced in May. That was done to avoid sending a more hawkish signal than we collectively intended. But I am not sure we thought enough about what we left out of our communications. We left MPC observers wondering how to square the following. On the one hand, we said slack was limited. On the other hand, we showed an inflation forecast that was two tenths above the target at the two year horizon, which would be relevant if there was truly no trade-off at all.

So we need to discuss collectively where we stand on this. Is there still a bit of a trade-off, which justifies this inflation overshoot? Or do we think that, on our central projection, we will need to tighten rates a bit more than market yields currently imply?

Note that the question "is there a trade-off?" is not simply answered by "is there an output gap?" You also have to take into account the shocks to inflation. For example, if we had a zero output gap to start with, but the inflation overshoot was all due to the exchange rate, the resulting optimal policy would still be governed by the trade-off framework. The inflation overshoot would require a tightening, but the tightening would lead to an output gap opening up, which would in turn reduce somewhat the total amount of tightening that is optimal. For what it's worth, a high-smoothing variant of optimal policy in November, calculated by the staff, did have a policy rate path that was slightly higher than the market path (by about one additional hike by year three), with inflation that was closer to target at the two and three year points. But what we really need to do is to discuss this among ourselves, so that we can come to a best collective view, which I don't think we really fleshed out in November.

There is an additional, bigger point to make about communication. We are now in a situation where there is little slack, current or prospective, yet the level of interest rates at the three year horizon that we condition our forecast on is around 130bp lower than in mid-2014, when there was more slack, weaker global growth, and we had a stronger exchange rate. Implicitly, we found more than 130bp of new headwinds in the past three years, or new reasons to lower our view of the neutral rate, or some combination of both. Put another way, over the past few years “limited and gradual” has gone from meaning as much as 180bp of hikes in three years, when we still had an output gap, to now meaning only 50bp in three years, with hardly any output gap. I am strongly in favour of having a more explicit discussion, internally at least, of why – or indeed whether – we think the appropriate path of rates is so flat. My sense is that the optimal path of interest rates consistent with our “smooth” forecast and current exchange rates and current fiscal policy, should probably be a little steeper. Thank you.

Governor Carney. Good. Thank you all.

So I join others in viewing this week’s decision as pretty straightforward and am inclined to vote for no change in the stance of policy. To my reading, there has been little data or survey news since November - yet - to change the IR’s outlook of modest growth at a pace just above its reduced rate of potential, with inflation falling back notably in the New Year to approach, but not reach, the 2% target by the end of the forecast period.

With others, I note the strength of global growth. I would comment that it looks like it’s probably going to run closer to 4% next year on a calendar year basis than the 3.6% we projected in November.

Domestically, the news has been more mixed but not inconsistent with our expectations, admittedly on limited data. As other have observed, the third quarter growth was unrevised in the second release. There were changes to the components, but I would suggest – taking surveys and other indicators into account – the broader picture remains one of rotation in demand, given where we are at this stage of the cycle.

The near-term outlook is a little weaker than it was at the time of November, following the disappointing construction data and falls in some of the business survey indicators. But further ahead, the notable fiscal loosening incorporated in the Budget provides marked upside news, even before any uplift from a potentially more orderly transition to our new relationship with Europe. And I’ll come back to that.

While our supply judgements remain broadly on track, I join others in expecting that our upcoming supply stocktake will be particularly lively, as it should be, given the substantial uncertainties around how rapidly net migration is shifting, how that could itself could be affecting productivity, and how quickly more generally productivity will recover, as Dave, Michael and Silvana and others have mentioned.

The latest evidence continues to suggest that spare capacity is limited and the labour market is continuing to tighten. Unemployment is now projected to fall to 4.0% in the first quarter, the lowest rate since early 75, and below the 4.2% that we incorporated in the November IR. Recruitment difficulties remain elevated and concerns about the availability of labour, unskilled as well as skilled, dominated the responses to Agents’ questions on companies’ ability to increase output. Again, coming back to net migration, it continues to fall back, largely reflecting fewer EU migrants coming to the UK looking for jobs. And I think as part of our supply stocktake as some have intimated, we are going to need to sharpen, or at least revisit, our general equilibrium treatment of net migration from the EU. Just for those who have looked at it in the past, it largely comes out in the wash in general equilibrium given the demand affect and the supply affect. We’ll have to dig down a bit more on survey and other evidence about job points and frictions that may be there and make some considered judgements. I don’t have a prior on those judgements. I am just picking up on what others have said.

Regular pay growth held steady in the latest data, in line with the November IR projections – that includes the data we had this morning – with compositional effects continuing to exert a substantial drag, although, as Silvana notes, that should come out in the wash on a unit labour cost basis. Evidence from microdata lends support to the idea that companies are targeting pay increases where recruitment and retention issues are most pressing. And that provides some comfort to a further tightening in the labour market and that higher churn will lead wage growth to strengthen as projected.

The near-term outlook for inflation has been pushed up by a recent rise in oil prices, largely offsetting the downside news in data. As always, the projection further ahead remains sensitive to movements in sterling, currently around 2% higher than our conditioning forecast in November. And, as we learned this morning, we will be writing a letter this week.[5]

[5] See footnote 2.

The information we have so far suggests the increase in Bank Rate is transmitting to the economy largely as expected. I won't go into all the detail, but pass-through on rates on new variable mortgages has been close to full and immediate, while that into new fixed rate mortgages is, as anticipated, happening more slowly.

As we discussed last week, pass-through to deposit rates has been more limited than anticipated. Rather than being full and prompt, reflecting a judgement around political pressures that banks and building societies said they were facing, it is proving gradual and partial, but consistent with historic averages.

As we discussed, the macro consequences of this more limited pass-through to deposits are small, lowering the level of GDP by the end of the forecast by less than 5 basis points.

There are no signs that the adjustments to the rise in Bank Rate are causing an overreaction amongst households, and I'll reference Andy's comments in this regard. We can look at a range of measures of consumer confidence, our inflation attitudes surveys, to see that households are largely taking this in their stride.

So, all in all, the economy is tracking broadly in line with the November projections.

There have been two important developments: fiscal, which I mentioned briefly and others have covered; and secondly around the Brexit negotiations.

We have a preview now of this week's summit. A transition deal is looking more likely and a cliff-edge correspondingly less so, meaning the change of regime is likely to happen in 2021 at the earliest, not 2019.

There is something in the draft agreement for everyone and you can see that in the briefings in the weekend papers. But given the UK and EU red lines, to my reading it looks more likely – and it will become more obvious over time – that the end-state to which we will transition will be a Canadian-style free trade agreement. How many pluses that will be added to that is an open question. I would suggest the Bank will have a fairly good line of sight to the most important answer, which will be around financial services, and we will probably get a read on that relatively quickly in the New Year. And we will clearly need to think carefully about the implications to our forecast, especially on the supply side.

I will say that what matters, as we have stressed, is not our interpretation of the news but how households and businesses react to it. I would join Jon in expecting that households will be pretty unsighted to the developments in Canada. Canada-plus will sound very similar to Norway or status quo for quite some time and the implications of a Canada-type deal will dawn gradually on businesses, depending on the sector. So overall, with greater confidence around smoothness of transition, and delayed recognition of scale of potential adjustment, I would suggest there will be some upside boost to wage settlements, consumer spending and potentially investment. We will see how attitudes react and attitudes adjust.

We emphasised last month that the projections in the November IR were conditioned on a further limited and gradual tightening in monetary policy. That still looks correct to me. As I said at the outset, I don't see a need to start implement that further tightening now.

We have discussed the merits of providing further conditional guidance about future policy and, if so, what form it should take. I would be minded to repeat how we view exceptional circumstances and the need to balance the trade-off, and that we have set out our framework at the time of the referendum and followed it consistently ever since. I would suggest that we remind people that our projections in November were conditioned on a path for Bank Rate that incorporated limited and gradual further increases in that Bank Rate over the next three years. Any attempt – I think in the spirit of others who have commented on this – I wouldn't go further than that in trying to be more finely tuned because it would be premature at this stage.

In other words, I would defer addressing Jan's point about the overshoot being either one of our preference (or preference in terms of balancing the trade-off) or whether there's an inadequate tightening in the yield curve. I would defer that until our next forecast. I think it is a very valid point. I think it was expedient at the time to focus on landing the rate increase in a way that didn't have the... the worse would have been a bigger overreaction, I think, in terms of risk management. But it is very on point, including the recursive point of, if you tighten more, do you open up a gap. And that is a very tough message to get across. So we will do with some time having discussion of that in order to refine and get it right.

I would also reiterate that we stand ready to reassess the outlook and adjust policy in either direction in response to policy developments, including those related to the process of EU withdrawal – insofar as they affect the behaviour of households and businesses, and therefore the outlook for inflation.

So with that, my hearing of everyone’s contributions were unanimity of inclination, in that we are all inclined not to change any of the elements of policy at this upcoming meeting, but we will decide on Wednesday. With that we can close this part of the meeting.

A meeting of the Monetary Policy Committee was held on Wednesday 13 December 2017. The following members of the Committee were present:

Mark Carney, Governor
Ben Broadbent, Deputy Governor, Monetary Policy
Jon Cunliffe, Deputy Governor, Financial Stability
Dave Ramsden, Deputy Governor, Markets and Banking
Andrew Haldane, Chief Economist
Ian McCafferty, External Member
Gertjan Vlieghe, External Member
Michael Saunders, External Member
Silvana Tenreyro, External Member

Richard Hughes was present as the Treasury representative

The following members of staff were present:

James Bell, Director, Monetary Analysis
Sarah John, MPC Secretariat
Simon Hayes, MPC Secretariat
Melissa Davey, Editor of Inflation Report

Transcript of the Monetary Policy Committee Meeting on

Wednesday 13 December 2017

Governor Carney. Welcome everyone. We will start with, I think, a brief data update from Andy.

> **Andrew Haldane.** Very brief. There's no really new UK data. The one piece I will mention, which is internationally, is that we had industrial production for the euro area for October. That was up 0.2. It falls hot the heels of last month having been negative. It leaves our overall nowcast for Q4 in the euro area unchanged at 0.7 on the month. I think that will do. Thank you.

Governor Carney. Then, secondly, just before we turn to the vote, we discussed last time – or I laid out the issues around – the response to the CPI number, which came out on Tuesday. We had the pre-release on Monday when we met and, as you know, it was above the 3% target[6], therefore necessitating an open letter. The question was around the timing and publishing that letter and I initially indicated that I thought on my quick read – and I had just received the CPI – my quick read of the Minutes[7] suggested that potentially we would be writing this week. Actually, immediately following that meeting we spoke with the Treasury and reflected a bit more on it. And the spirit of the remit is actually that there is a time for reflection. And I'll quote, the remit states "the reason for publishing the open letter at that time" that is (this is parenthetical) within the Minutes of the following MPC meeting is "to allow the Committee time to form and communicate its strategy towards returning inflation to target after consideration of the trade-offs." And with the Treasury, we agreed that this intention is not best served by needing to produce an exchange of letters within a couple of days. Especially since the pre-release security arrangements, which are new, would prevent us from sharing the information sufficiently promptly with staff on whom we would rely for detailed analysis – with staff within the Bank of England and also within the Treasury, the staff would not have any pre-release information or detailed information, making the exchange of an Open Letter difficult. And, of course, this was part of the original rationale for the change of remit a few years ago. Previously we had to exchange letters on the day of the CPI release itself, and it showed in some instances in the quality of those exchanges. So, as the world knows, we will be exchanging letters with the Minutes, or with our subsequent decision, which happens to be an Inflation Report month.

So with that, we will turn to today's decision and I would invite the Committee to vote on the following three propositions. The first, that Bank Rate should be maintained at 0.5%. Secondly, that the Bank should maintain the stock of sterling non-financial investment grade corporate bond purchases financed by the issuance of central bank reserves at £10 billion. And thirdly, that the Bank should maintain the stock of UK government bond purchases financed by the issuance of central bank reserves at £435 billion. And I will go in the order we indicated last time. And I'll start with Ben.

> **Ben Broadbent.** I vote for all three propositions.

Governor Carney. OK. Silvana.

> **Silvana Tenreyro.** I vote for all three propositions.

Governor Carney. Andy.

> **Andrew Haldane.** I vote for all three propositions.

Governor Carney. Thank you. Dave.

> **Dave Ramsden.** I vote for all three propositions.

Governor Carney. Ian.

> **Ian McCafferty.** I support all three propositions.

Governor Carney. Thank you. Michael.

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[6] Clarification added by the MPC Secretariat: Speaker meant to say "threshold [for triggering an Open Letter]."
[7] Clarification added by the MPC Secretariat: Speaker meant to say "Remit".

Michael Saunders. I vote for all three propositions.

Governor Carney. Good. Jon.

Jon Cunliffe. I vote for all three propositions.

Governor Carney. And Jan.

Gertjan Vlieghe. I vote for all three propositions.

Governor Carney. And I, as well, vote for all three propositions. Which means that all nine of us have voted for all three propositions and therefore nobody voted against any. And with that we'll close the meeting and we will go downstairs and work on the minutes.