



**BANK OF ENGLAND**

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**MEETINGS OF THE MONETARY POLICY COMMITTEE**

**June 2017**

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A meeting of the Monetary Policy Committee was held on Monday 12 June 2017. The following members of the Committee were present:

Mark Carney, Governor  
Ben Broadbent, Deputy Governor, Monetary Policy  
Jon Cunliffe, Deputy Governor, Financial Stability  
Kristin Forbes, External Member  
Andrew Haldane, Chief Economist  
Ian McCafferty, External Member  
Michael Saunders, External Member  
Gertjan Vlieghe, External Member

Dave Ramsden was present as the Treasury representative

Dido Harding was present as an observer in her role as a member of Court

The following members of staff were present:

Gareth Ramsay, Director, Monetary Analysis  
James Bell, MPC Secretariat  
Alan Castle, MPC Secretariat  
Bob Hills, MPC Secretariat  
Matthew Tong, Deputy Editor of *Inflation Report*

## Transcript of the Monetary Policy Committee Meeting on

**Monday 12 June 2017**

**Governor Carney.** Ok, morning everyone. Ben, I'd like to ask you to start with what was the reaction in the last couple of days in financial markets.

**Ben Broadbent.** Ok, well, two or three things I think, most of them associated with the General Election. Most important is sterling fell on impact by around 2% and recovered a little ground, but is still 0.8% lower than at Pre-MPC and 2.4% lower than the level assumed in the May *Inflation Report*. That helped to sustain prices of UK equities in aggregate, but that was very much focussed on firms with foreign earnings; prices of equities of domestic facing firms fell back by 1½% on the day of the election, driven mostly by banks and house builders. Interest rates haven't moved much. At the front end, they are marginally lower than the May IR, slightly higher further out, so there's been a slight steepening. And finally, completely unrelated to the UK General Election, oil prices are slightly lower thanks to stronger inventory data in the US – \$48 a barrel down from 52 at the time of the May *Inflation Report*. That's it.

**Governor Carney.** Ok, thank you Ben. So, two data points. The CPI, which will come out tomorrow morning at 9.30, is up 2.9% and this just came in so I don't have the chart versus ours. But I believe on both cases 0.1 above staff monitoring so it's up 2.9, 12 months CPI, that's up from 2.7 in April. I believe we are 2.8 right for staff monitoring. And the main upward effects came from recreation and culture, electricity, food, clothing, furniture and household goods. The main downward effects came from falls in air and sea fares, and fuel prices. And then core inflation is also up, that's right, so this is ONS core, so in other words CPI excluding energy, food, alcohol and tobacco, so it's 2.6 in May. So 1.8, 2.4, 2.6 and I believe we monitor that and it's 0.2 higher, ok. So CPIX 0.2 higher, CPI 0.1 higher and fairly broad based. I will say that, just as an editorial comment which will come out in eight years' time, that it is incredibly difficult to read this thing now that the first 40 pages are now CPIH and the charts are all CPIH and, you know, it would be nice if that's what we cared about, but actually when the front page of the print comes out it says 12 month inflation was 2.7 in May, which is [indecipherable] ... that is a little editorial thing. So that is CPI, that will come out tomorrow morning 9.30 – we get the detail then.

On the LFS, slightly different direction. Three months to April, employment rates stayed at 60.7, 109,000 more people in work, slightly weaker than staff expected. Staff expected 60.8 so we have a slight uptick in the inactivity rate to 36.4 from, sorry, that's flat – it's up 0.1 relative to staff expectations of 36.3. Pay is weak, there's no way around it. Annual, whole economy AWE total pay including bonuses 2.1%, whole economy regular pay, excluding bonuses, 1.7%. We had monitored 2.3 and 1.9 and, for what it's worth; three months to March were 2.4 and 2.1 respectively for that. Average hours flat at 32.2. So...

**Michael Saunders.** Do we get the unemployment ...

**Governor Carney.** 4.6, sorry, sorry yeah.

**Ben Broadbent.** Which is in line right ....

**Governor Carney.** 4.6 in line and obviously consistent with, the same rather, as last time round. Ok, Andy can you summarise any other public data that's come out?

**Andrew Haldane.** Yes, just since we last spoke there has been one or two bits and bobs, so we had the Index of Production and Construction Output for April, both of which were somewhat weaker than our expectations. On the other side, we have also had however some somewhat stronger net trade data with exports up and imports weaker, and the staff have also started looking at some early indication of what services output might be, based upon a turnover survey, and that is also a little bit stronger. The net effect of all of that is to leave our nowcast for Q2 unchanged at 0.4%, I think it's fair to say that that's now a weak 0.4 rather than a solid one. I think that's all, thank you.

**Governor Carney.** Ok. Very good, so I'll invite colleagues to go and give their indications. The propositions that I'm going to put forward are that Bank Rate is maintained at 0.25%, secondly that we 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 we maintain our stock of government bond purchases, financed by central bank reserves, at £435 billion. So I'll start with, start with Ben please.

**Ben Broadbent.** Thank you Governor.

Let me first as usual go through the highlights of the international data.

On growth, the news has been generally positive, unambiguously so in the case of the eurozone. So eurozone growth in the first quarter estimates there of have been revised up to 0.6%, from a flash of 0.5. The composite PMI for May was unchanged at 56.8, which is a six-year high. The employment indices were particularly strong – the strongest ever in the case of manufacturing. The same goes for the German Ifo measure of industrial-sector confidence, which in May registered the highest reading in the 26-year history of the series. Most outside forecasts for eurozone GDP require a slowdown in sequential growth through this year and are more likely therefore to be revised up than down.

The same may be true of Japan. The nominal side is still weak – wages as well as prices – but GDP grew by  $\frac{1}{2}\%$  in the first quarter, significantly faster than expected and also faster than any estimate of trend. This marks the fifth consecutive quarter of growth, which is the longest run of positive numbers for a decade.

US data are more mixed. Estimated GDP growth was revised up slightly in Q1, from 0.2 to 0.3%, and the expenditure data suggest that we remain on track for a rebound to 0.8% in Q2. But the business surveys are not as strong as in the euro area and, on the month, there were a few weaker readings. Durable goods orders fell back; employment growth has clearly softened – additions to non-farm payrolls have averaged 120,000 in the past three months, which is the lowest figure for five years – and inflation in the core PCE deflator fell to 1.5%, the lowest since December 2015. The rates market is still confident of a Fed hike this week, but we have seen something of a redvergence between the Fed's dot plots and the market path of rates in the forward curve.

Risks to financial stability in China remain, and there have been occasional signs of strain in the interbank market, where lending has grown significantly over the past year. Those strains could increase if the PBoC matches the Fed's rate rise later this week.

The overall picture, however, certainly on a UK-weighted basis, is of a firmer global backdrop. Coupled with easier financial conditions, including a sharp decline again in sterling's exchange rate over the past month, this is providing significant support for the domestic economy.

That is evident in surveys of orders and investment intentions in manufacturing. It is much less evident – or perhaps just offset by other, domestic factors – in much of the official data. Retail sales bounced back in April but other indicators of consumption – the retail surveys for May and, in particular, car registrations in April and May – are weaker. Somewhat at odds with the surveys, and as we have just heard from Andy, official estimates of output in manufacturing and construction were also weak in April. Even near its end there is still considerable uncertainty about overall growth in the second quarter, but the May forecast of 0.4% still looks a reasonable one.

Whether that's above or below trend is hard to say, given the lag between output and employment. The latest published employment data, for Q1, have more to do with demand growth last summer and autumn than with current trends. But, at least on the quantities side, those data are nevertheless strong, thanks partly to a switch into full-time employment. Total hours worked rose by 0.8% between Q4 and Q1. Unemployment fell to 4.7, 4.3 in the survey for March alone. And as we have just heard unemployment edged down to 4.6% in the three months to April. Notwithstanding any weakening in the economy into the New Year, surveys of employment intention remain firm. So that March reading for unemployment may be an outlier, but the surveys suggest the near-term trend in unemployment is still downwards.

And yet, as we know, wage growth remains weak. Excluding bonuses, AWE growth fell to 2.1% in Q1, from 2.6% in Q4. On an hourly basis, if you can believe such numbers – deflating AWE by

average hours in other words – the deceleration would have been that much more marked. And, as we have just heard, pay growth in the three months to April, again excluding bonuses, fell to 1.7%, 20 basis points lower than our expectation. All this means that, despite weak productivity, despite lower unemployment, growth of unit wage cost still looks well below par.

Now it is true that, despite this, inflation has picked up strongly. In May, the headline rate was 2.7, and we now know that in, excuse me in April, and in May it has risen to 2.9. Core inflation has risen significantly, from 1.8 a couple of months ago now to 2.6. The latest STIF projections already had inflation hitting 3% later this year, we have yet to see what those do factoring in the latest numbers, but it seems likely that our central expectation will now be that we will have to write a letter at some point.

Now as we know, in the main, all this reflects mostly the acceleration in import prices. But it also reflects I think surprisingly robust corporate margins. In contrast with the depreciation in 2008 and 2009, when the rise in import prices was partly absorbed by firms, and operating margins were significantly squeezed, it looks as though, if anything, they've actually risen slightly over the past year.

It's not entirely clear why this has occurred. It may be that firms reliant on imports bought them further forward than usual ahead of the referendum but, aware these contracts will soon be rolling off, have pushed up final output prices anyway. This would also help to explain why import prices themselves have been weaker than we had expected given the scale of sterling's decline. More fundamentally, it may simply be because the economy's not in recession, as it was in 2008/9. Margins are procyclical.

Now swings in import prices and operating margins are clearly important for inflation in the near-term. And they could – if they were to feed through to inflation expectations, including those among firms – they could help sustain a rise in inflation for longer. In a small, open economy like the UK, these factors can help to explain why it's hard to detect a Phillips curve in price space.

But their influence is likely to wane over time. There seem to be fewer structural forces on the profit share than in the US. So it's reasonable to think that our measure of margins is mean reverting. So margin expansion is unlikely to be a source of inflation over the medium term, even if it has been over the past year and nor is import price pass-through. We were told at Pre-MPC that the forecast implies, or requires rather, that sequential rates of output price inflation should now start to come down; to me that is exactly what the latest price surveys suggest.

So the critical judgement, for me still involves the contrast between quantities and prices in the labour market. How much faith do we have in the Phillips curve?

That faith has clearly been shaken. The conjunction of strong quantities and weak wage growth has been with us for quite a while. Nor is it restricted to the UK. The most important response we've made is to lower our estimate of  $U^*$ . We say that the Phillips curve has shifted. More recently, the fact that – at least according to the Agents – firms have been able to respond to particular staff shortages more forensically, awarding individual pay rises as necessary and avoiding anything more general, could suggest that the Phillips Curve is also flatter.

But I'm not ready to give up on it entirely. Flatter doesn't necessarily mean flat. Our May IR forecast for accelerating wages was greeted with a degree of scepticism, but continued falls in unemployment must make it more likely. With little or no output gap, and a forecast which looks set to be based on a significantly weaker exchange rate than in May, a rise in interest rates at some point becomes more warranted.

I still don't see a pressing need for tighter policy this month however. To my mind, the domestic factors depressing growth in the UK relative to that in the rest of Europe, even in the face of a much

weaker exchange rate, clearly exist. As Brexit negotiations begin, with no clear strategy from our own government and a hardening tone from others in Europe, those forces may intensify. Indeed I expect them to. If they do not – if businesses continue to act on the assumption of something like a smooth, or even a delayed, Brexit, as our May projections assume – a rate rise will become necessary. But I think we have a little more time to see whether they will and I therefore expect to vote on Wednesday for no change in either Bank rate or the stock of purchased assets.

**Governor Carney.** Thank you Ben. I have Michael and then Jon please.

**Michael Saunders.** Thank you Governor. I am inclined to vote for a 25 basis point rate hike this month.

**Governor Carney.** Sorry can you repeat that so Andy can hear, because he missed it with the cough!

**Michael Saunders.** For those that were choking in the background. I am inclined to vote for a 25 basis point rate hike this month.

So the key reason is that the prospective trade-off between above-target inflation and slack has worsened further and, I suspect, will be even worse than our base case. The likely trade-off is now somewhat beyond my limits of tolerance.

With pass-through from sterling's depreciation, the three-month on three-month annualised inflation rate is around 4% for headline CPI inflation and around 3% for core inflation. Various guides that are sensitive to currency pass-through, including PMI output prices and the Bank's Agents reading for prices of finished imports, indicate that CPI prices will continue to rise quite strongly in coming months. The staff forecast – even before the update reflecting May figures – reaches 3% late this year and I suspect that, as appears to have occurred in prior cycles, the overall pass-through to inflation from sterling's depreciation will be somewhat greater and more protracted than the Bank's base case, with some margin expansion for domestic producers of tradable goods and services alongside the direct effect from higher import prices.

At the same time, slack continues to shrink faster than expected. The jobless rate is the lowest for more than 40 years, under-employment has fallen sharply in recent months, while vacancies and recruitment difficulties are rising again.

To be sure, the ONS report a marked slowdown in Q1 GDP growth to 0.2% quarter to quarter. Such a pace, if sustained, would probably imply rising slack, even given the low potential growth rate. However, in judging the economy's underlying pace, I suspect it is probably better to average the last two quarters, which points to 0.4 or 0.5% quarter to quarter. The Q1 GDP data were depressed by marked – and probably erratic – declines in pharmaceuticals output and sales by small retailers, reversing equally erratic gains in Q4. Moreover, the ONS tend to revise up Q1 GDP growth more than any other quarter. For example, over the period 1993 to 2014, the average revision to Q1 growth has been up 0.2 to 0.3%. The average revision for the other quarters is below 0.1 percentage point.

Either way, the nowcast for Q2 growth is around 0.4% quarter to quarter, with pickups in exports and investment broadly offsetting sluggish consumer spending. This pace of growth is similar to the average of 2015 and 16. It is not spectacular. But, the experience of 2015 and 16 – with unemployment and under-employment falling steadily – suggests that this pace of growth is slightly above potential. Surveys of firms' hiring intentions hint more clearly that labour demand growth continues to outstrip labour supply.

The modest pace of wage growth, which we've heard confirmed, suggests that the labour market has not yet overheated, consistent with our judgement that  $U^*$  is below 5%. Nevertheless, slack is probably limited. Roughly half of the DGI measures are now above their target-consistent pace, and

half below. Given trends in labour demand, I expect that the jobless rate will probably reach our 4½% U\* figure in the next couple of months and edge below that level thereafter.

I do consider it possible that U\* currently is somewhat below 4½%. But, if we are going to test the lower limits of the equilibrium jobless rate below 4½, I would like us to do so cautiously, especially with the prospect of an extended inflation overshoot. As the provisional staff work indicates, we do not currently have strong evidence to revise our 4½% U\* estimate significantly.

So far, inflation expectations across the economy are not yet overly high. But the strength of firms' expectations for selling prices hints that inflation expectations may perhaps not be as well anchored as we assume.

Last month I was close to voting for a hike, but held off because of the possibility that the plunge in March retail sales signalled a much more abrupt consumer slowdown than our base case. That risk has not been eliminated, but it looks less compelling now given the equally sharp rebound in April retail sales and the steady trend in consumer confidence.

Overall, I believe that policy should remain somewhat accommodative, but that the current degree of stimulus – which has our foot pretty much to the floor – is excessive, and likely to create an adverse trade-off between above-target inflation and shrinking slack. A 25 basis point rate hike would still imply a relatively loose policy stance, continuing to support output and jobs. Policy would remain looser than before the Brexit vote. Such a stance probably would still allow unemployment to fall to new record lows. But it might improve the prospective trade-off somewhat, and reduce risks that the combination of above-target inflation plus record lows in unemployment erodes the credibility of the inflation target.

I want to stress that my vote for tightening is driven by broad economic conditions, and is not a response to the rise in political uncertainty after last week's election.

I did consider whether this rise in uncertainty justifies deferring tightening. After all, a year ago, the MPC responded to higher uncertainty after the Brexit vote by loosening policy, reflecting expectations that uncertainty would weaken demand more than supply and hence increase slack in the economy.

However, in my view, the current situation is notably different to the aftermath of the Brexit vote. In particular, it is less clear what, if any, are the long-term economic consequences of last week's election. A year ago, it was reasonable to assume, consistent with the OECD and the IMF, that Brexit would modestly worsen long-term UK potential growth. Under those conditions, it seemed plausible that heightened uncertainty would cause demand to weaken markedly near term, adjusting to that weaker long-term outlook. By contrast, it is unclear whether the current political uncertainty will produce economic policy changes at all, and, if so, whether such changes might support growth, for example, through reduced fiscal tightening – softer Brexit – or hit growth eg, less chance of smooth Brexit.

Moreover, unemployment is lower now, and inflation above target whereas it was below target a year ago, and global growth is improved. Hence, the previous risk management asymmetry, that it was less risky to overdo stimulus than to underdo it, no longer applies in my view.

So I am not persuaded that heightened political uncertainty at present affects policy either way. I would prefer to hike now, and then to be ready to respond either way as needed to economic developments.

To be sure, an early rate hike might surprise markets. But we have clearly warned that rates may rise earlier than priced in. I do not believe that we must wait until markets stop ignoring us. Moreover, a rate hike would probably not be such a surprise to the real economy. Surveys suggest



that a clear net balance of households and companies already expect interest rates to rise in the coming year – and presumably this is built into their spending decisions.

Finally, given evidence that the neutral level of rates is well below historic norms, we should stress that any tightening probably will be limited and gradual, and this is regardless of whether rates do rise this month.

I do want to highlight that my vote is indicative. I am very interested in what others think and, as always, reserve the right to change my vote for Wednesday. Thank you.

**Governor Carney.** Very good. Thank you Michael. Jon and then Ian please.

**Jon Cunliffe.** OK. The key question for me this month, as we are at the meeting between forecasts, is really whether the economy remains on track to meet the central projection in the May forecast and particularly whether we're seeing the slowdown in activity and particularly consumption that we expected. I mean there are also clearly tail risks, rather fat tail risks, around the negotiation and implementation of a Brexit deal – and uncertainty around that outcome has probably increased. But the picture there will not become clearer for a while. The key issue for us at present is whether the forecast as I say remains on track, bearing in mind that our forecast had an average of possible outcomes for the long run impact of Brexit and assumed a smooth transition to the UK's new relationship with the EU.

On the International side, the news since our last meeting gives me a little more confidence that the global pickup will continue in line with our forecast. Especially in the US, despite the fading of Trump-inspired optimism, the US economy looks set to rebound in Q2, with April data, along with March revisions, suggesting that Q1 weakness in consumption was rather erratic noise and other indicators – unemployment, investment – signalling strength. At 4.3%, unemployment is at its lowest level since May 2001. It's worth noting however that US inflation at 1.7% in April is weak. The euro area growth looks set to continue into Q2 at about the rate of Q1 given the signal from PMIs and other survey indicators.

On the domestic economy, we are starting the second quarter from a weaker position than we thought: the second release of Q1 GDP was just 0.2% down 0.1 percentage point from the first release and down 0.5 percentage points on the 2016 fourth quarter. The Q2 expenditure split for consumption and business investment were broadly in line with our expectations, but net trade came in weaker due to a stronger-than-expected increase in imports. And indicators for the second quarter are consistent with our nowcast of 0.4%.

In line with the Q1 forecast, and despite the fact that a number of the surveys and other data such as consumer confidence had seemed to be signalling something stronger, growth in household consumption fell from 0.7% in the last quarter of 2016 to 0.3% in the first quarter of this year. The largest spending adjustments for UK households in Q1 appeared to be in purchases in relatively discretionary items, household goods, while essentials such as spending on food held up relatively well. That would in my view be consistent with households beginning to cut back in the face of weaker real incomes. And looking forward the most important issue on the domestic economy as I say is whether the strong consumption growth we saw in the second half of last year – which began to slow in the first quarter of this year – would remain subdued in the current quarter in line with our forecast of 0.2%

The April retail sales figures appeared to suggest a bounce back in consumption but the more recent indicators suggest that May was weaker. A fall in the retail sub-sector drove a fall in the CBI's reported sales balance back down to its historical average. According to the BRC, the total volume of retail sales fell by 2.3% in the year to May – down 2.9% on a like-for-like basis. And Visa has reported that seasonally adjusted spending was 1.8% lower in May than in April. Retail sales of

course are only one element of consumption. But, since they began slowing sharply at the end of last year, they do seem to be carrying a signal about consumption overall.

And early indicators on car sales in Q2 are particularly weak, with new car registrations down 7.1% for the three months to May.

Even though the latest indicators look a little weaker, they would still as we saw in our models tend to point to stronger consumption growth than in our forecast. But the latest indicators remain in the same territory as in Q1. And, on balance, while there is evidence both ways, I am not at the moment persuaded that there is a clear upside risk to our consumption forecast.

I do think however that there is a downside risk to this forecast – the signal from the housing market.

In the aftermath of the referendum, we forecast that the housing market would falter – approvals going down to 55,000 a month and house prices to fall over the following year largely based on the impact of uncertainty. That downturn did not materialise and we recast our forecast back to over 70,000 approvals per month and house prices to rise. But we are now seeing a slowdown in both activity and prices. Approvals have fallen for three consecutive months, going below 65,000 in April. And the most recent release for both major price indices show house prices falling, with the average of lender indices going negative in May to -0.8% three month on three month.

Some of this fall may be attributable to changes in the buy-to-let market as buy-to-let investors are faced with higher stamp duty and higher tax. That seems to be true in the early months of the year, possibly driven by the tax change in April, but it's unlikely that a slowdown in buy to let could have accounted for all of the weakness. Buy-to-let approvals would need to have fallen a further 60% to account for the falls we've seen since January.

Instead it seems plausible to me that slower housing market activity and house price growth are due to an income squeeze. House prices in the UK are strongly correlated with income and particularly income prospects.

Perhaps the most convincing sign of strength in the economy is the labour market. Employment grew by 0.4% in Q1, considerably above our forecast of 0.1%, and there are a range of survey indicators which point to some continued growth though at a lower rate. Unemployment is at 4.6%, just above our U\* estimate.

And the labour market looks tight on the usual indicators such as survey measures of recruitment difficulties, job to job flows and quit rates all of which have been higher in recent quarters than their post-crisis range, though, as Kristin pointed out, quit rates have levelled off in the latest readings.

While it may be evidence of strength in the economy, the continued growth in employment and signs of a tightening labour market have not however led to any pay pressure. The latest survey measures point to wage growth continuing at its relatively subdued rate in the near term. And as we saw at Pre-MPC, statistical models point to lower pay growth than we have in our forecast going into the second half of the year, and the latest readings on AWE that we heard this morning are lower than we were expecting. So there is for me nothing to suggest that higher pay will compensate for higher inflation.

Although pay remains subdued, core inflation has been rising. Staff analysis suggests that the majority of the increase in core inflation has come from imported goods rather than DGI though a number of DGI measures have picked up a bit. And that's something clearly that needs to be watched. But the inflation expectations heatmap remains consistent with our latest forecast.

So, overall, the economy to me seems to be evolving broadly in line with our most recent forecast. While not conclusive, I think the latest indications appear to bear out a slowing in consumption as a



result of a squeeze in real incomes which now also seems to be affecting the housing market. On the other hand, the labour market probably continues to strengthen.

In the light of these developments, I have no reason to change my vote and I am minded to vote in favour of all the propositions.

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

**Ian McCafferty.** Good morning everyone. Last month, I summed up our *May Inflation Report* forecast as one that portrayed an economy in which the projected GDP slowdown was only modest, in which the output gap all but closed by the end of the forecast horizon, and in which inflation not only remained above target through the horizon, but was also no longer moving directly back to target beyond it. The trade-off we faced had therefore shifted further in an uncomfortable direction, and for me was right at the end of my inflation tolerance by year two, and above it as the trade-off disappeared in year three. This discomfort with the trade-off was heightened by my concerns about our estimate of the size of the remaining output gap and whether the forecast fully reflected the inflationary consequences of the sharp depreciation of sterling.

I concluded that such an outlook would, for me at least, justify a pretty immediate start to the reversal of the stimulus that we put in place last August, were it not for the high degree of uncertainty surrounding two key issues: one, the degree to which the Q1 retail sales and GDP data might be a signal of a more profound slowdown; and two, how far those upside inflation risks might be materialising.

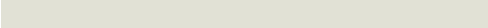
The key questions for this month, therefore, are: how much light does the recent data throw on those two key issues, and has my level of confidence in the central path of the May forecast therefore increased?

Well, while no single data point has been incontrovertible, I conclude that there have been some important signals in the mix of the data that provide me with significant reassurance that our May forecast remains on track. Indeed, in current circumstances, it would be most unusual were the data to have provided such dramatic evidence to be incontrovertible. Such unequivocal data shifts occur only rarely, and usually when the economy is tipping into full recession. By contrast, a complex economy such as the UK edges into overheating and inflationary pressure only gradually, such that by the time it is fully evident in the data, it is, in policy terms, verging on too late.

So what can be gleaned from the recent economic news?

On the international front, the news is encouraging. The Q1 dip in US GDP growth increasingly looks to be anomalous, with a strong rebound expected in Q2, while the euro zone continues to surprise on the upside, with the solid performance of Q1 looking to continue into Q2. The recent pickup in trade, which suggests that this pick up in momentum is relatively broad-based across the global economy, suggests that there might now be a little more upside risk to our global projections, even though the big event risks that could knock this all off course – a financial crisis in China, conflict escalation in the Middle East and Korea, and other such risks – still remain of course in the background.

Domestically, I am now more persuaded that the sharp fall in Q1 retail sales and the resulting drop in GDP growth is not the start of a more dramatic slowdown than envisaged in the May IR. Although retail sales remain volatile on a monthly basis, other indicators of consumer attitudes, sentiment and purchasing intentions have softened a bit but not dramatically, while the NMG survey confirms our previous assumption that consumers are prepared to smooth at least part of the real income squeeze through adjustments to their savings. There are clear signs of some slowing in the housing and car markets, but it appears that the key drivers of each are idiosyncratic to those markets, such that they provide only limited signals to underlying consumer attitudes.



In the housing market, the price weakness is most marked in London and the south east, where the sharp increases in prices in recent years have left income multiples at extreme levels, and where the shift in foreign buying since the referendum hits hardest. The latest RICS survey also concludes that some of the recent weakness can be attributed to election uncertainty, and is expected to be relatively short term.

In the car market, the slowdown in sales is partly attributable to the tax changes, but also to a change of focus by both manufacturers and dealers away from shifting volumes at ever more discounted prices. As such, it is less clear that the weakness in the car market is acting as a broader signal for consumer spending more widely.

For Q2, the survey evidence suggests that the underlying momentum in activity has held up, in spite of the slightly weaker than expected April IP data, which was hit by volatile weakness in the pharma sector. The Agents' reports suggest some strengthening relative to Q1, and the rebalancing narrative in our May forecast remains intact.

The slower-than-expected Q1 GDP appears at odds with the news in the labour market data. Either true productivity growth has collapsed again, or activity was really stronger than the measured preliminary GDP. Either way, the implications for the output gap are the same, and the remaining output gap is closing faster than predicted. It is of course possible that the true rates of full employment, maximum hours and participation sit below our current star estimates, but the unemployment rate in the three months to March is, at 4.6%, at its lowest since 1975, and the employment rate for those 16-64, at 74.8%, the highest since 1971. Even if our star levels of full employment have fallen relative to the last 25 years, in which they could have been elevated because of the generational hysteresis inherent in accelerated industrial structural change, it's still, I think, a stretch to suggest that the labour market is not now effectively verging on full employment.

Relative to May, it therefore appears that the output gap will be closed somewhat earlier than expected, relieving us of the need for a policy judgement based on trade-off calculations.

It remains the case that the evident labour market tightness has yet to result in any material pickup in wages. So far, we have attributed this either to the presence of greater slack, or to a shift or flattening of the Phillips curve, for which we have few structural explanations. Kristin has advanced the hypothesis of a lower churn rate – workers are now more attached to job security, even at the expense of constrained wages, and I have some sympathy for this argument. But an additional explanation is at least plausible; that weak wages are a function of a more structural shift in the labour share, driven by actual or threatened substitution of capital for labour. Labour shares have fallen consistently in most advanced economies for some time, but until recently the UK has been an outlier, as a result of increased employer DB pension contributions, but has recently reverted to a pattern similar to that in other countries. As a share of GVA, non-oil corporate profits have been rising since 2012, and are now at their highest since the first quarter of 2000. They have been higher than this in only nine other quarters in the past 27 years, all in the late 1990s. As a result, it does look that the benefits of increasing pricing power, generated by full capacity and justified or excused by higher input costs, are remaining more with employers, such that we can have a recipe for rising inflationary pressure without an early rise in wages themselves.

In terms of the inflation outlook itself, it is still a little too early to judge whether my fears of the upside risks to our inflation forecast are materialising, although recent anecdotal evidence about the timing and extent of firms' currency hedging leads me to believe that it is unlikely that pass through is taking place faster than normal. However, if the post-election weakness of sterling persists, our projected peak for CPI inflation will rise to over 3%, which in my view risks exerting a more material influence on inflation expectations.

If these were the only issues at stake, I would be minded to vote this month for a modest reversal of some of the stimulus that we put in place last August. However, the election result provides one further potential complication, were it to lead to a lasting or material influence on business or consumer confidence. I suspect that this will not prove to be the case, as we discovered last year in response to the referendum result, when the impact on confidence was both limited and temporary. But before committing myself to a decision later this week, I would like to use the next 36 hours to take the temperature of some business contacts.

But I retain my bias towards a gradual removal of stimulus. I have made the case in the past for the advantages of gradualism in policy changes, and continue to believe that this is an important issue. Normalising policy only gradually, particularly after an extended period in which rates have remained at such low levels, allows all actors to adapt to each change, and therefore minimises risks of overreaction.

So, I am minded to vote for an increase, but give me 36 hours to take a little bit more of the temperature.

**Governor Carney.** Ok, thank you Ian. I have misplaced my order, and I have Andy and then Jan, sorry, thanks.

**Andrew Haldane.** Thank you Governor. Last month, I concluded that the balance of monetary policy risks between raising rates too early and doing so too late had changed over the course of the past six to nine months. Until recently, I had been placing a greater weight on the potential risks associated with raising rates too early. The most important of those was the risk of snuffing out what had appeared, over a number of years, to be a rather patchy and anaemic recovery, despite an apparently highly-accommodative monetary policy stance. The other risk which weighed with me was the one associated with the asymmetry in the effectiveness of our tools near the ZLB at a time when there appeared to be a material downside skew in inflation expectations. Both of those risks seem to me to have shifted recently.

Growth, both in the UK and globally, has out-performed expectations over that period, displaying surprising resilience despite a sequence of shocks, economic and political. That greater resilience in growth may be the result of it having a somewhat broader base. By that I mean greater breadth in the composition of growth, with signs (albeit still early-stage signs) of investment and exports playing more of a role, and consumption somewhat less, in supporting growth. But also greater breadth geographically, with most regions of the world now growing at or above trend.

At the same time, and probably not coincidentally, inflation expectations in both in the UK and globally have adjusted upwards, or perhaps more accurately their downward skew appears to have disappeared. Like growth, they too now seem more resilient and better anchored.

In combination, greater resilience in both growth and inflation expectations has, for me, left the risks of tightening too early lower than last August.

As for the risks of tightening too late, they would manifest themselves in rates needing to ratchet higher if monetary policy was playing catch-up to contain nominal demand pressures. In the past, those have tended to be the conditions in which monetary policy has contributed to, rather than averted, recessions. This risk of monetary policy needing to play catch-up appears, to me, to have increased over the course of the past nine months, as the already flat sterling yield curve has flattened further.

I'd hoped the May *Inflation Report* might bring about some correction in the sterling yield curve, with the output inflation trade-off gone in the third year of our projections and with inflation above target and rising at that point. In the event, some combination of – first, an already higher yield curve by the time of publication than the one on which our projections were based; second, market

participants holding a different view of the likelihood of a disorderly Brexit than the one assumed in our IR projections; and, third, the general insensitivity of market yields to our inflation and output projections at more distant horizons – meant the yield curve was, if anything, a little softer after publication than before. The sterling curve is now essentially back in line with a path underlying the May IR, with a rate rise not fully priced until early-2020.

So what other news has there been over the period since the *Report*?

On demand and activity, the picture does not appear to me to have changed significantly. Survey-based measures of activity continue to hold up and to be consistent with around trend growth, with only a modest slowing from last year. Surveys of confidence, both among businesses and consumers, have been similarly resilient. There are clearer signs of changes underway in the composition of demand, with a rebalancing away from consumption and towards corporate spending and net exports. Even for consumer spending, however, it's unclear this slowdown is any more pronounced than the one contained in our May IR. The wide month-to-month swings in retail sales volumes and car registrations – to take two prominent examples – make discerning the incline of the slope in these variables nigh-on impossible, beyond the fact that it is negative, probably.

And then, of course, there's the small matter of what might be happening to the remaining 60% plus of consumption. It is clear that the housing market is slowing, with knock-on effects to spending on the likes of household goods, whose volumes fell by almost 4% in the first quarter. That weakness has been offset, to some extent, by strength in the primary market where housebuilding activity has been buoyant. Whether that housebuilding binge would survive a long or sharp downturn in the secondary market strikes me as extremely questionable, if house builders' historic patterns of behaviour are repeated. Even so, it's not clear a materially weaker path for the housing market than contained in the May IR necessarily poses a downside risk to our consumption projections. The staff model with house prices falling modestly through this year is signalling roughly 0.2% quarterly growth, in line with the May IR. Most of our other models of consumption – based on indicators which, historically at least, have had a closer relationship with consumption – point to growth closer to trend.

Meanwhile, the picture on investment looks to have strengthened over the past nine months. Surveys of investment intentions indicate that business investment growth should move further into positive territory in Q2, having contributed positively to growth in Q1. Furthermore, export surveys and monthly hard data for April suggest that net trade might make a material contribution to growth in Q2, with risks to the upside relative to the *Inflation Report*.

On the nominal side, the biggest news by far over the month has, once again, been in the exchange rate. This is around 3% lower than at the time of the May IR, a good chunk of which reflects political events in the run-up to and following the General Election. A mechanical staff update of our projections for the full set of asset price news since the May IR leaves the level of GDP around 0.4% higher at the year two and year three horizon and inflation around 0.2 percentage points higher, at 2.4%. On that basis alone, the risks of leaving too late any monetary policy tightening have probably nudged a little higher since the May IR.

Where all of this leaves me policy-wise is to believe that a partial withdrawal of the incremental insurance the Committee took out in August last year can be justified at some point soon. By soon, do I mean this month? Well I think there is a strong case for holding off this time, for two reasons.

First, there are enough straws in the wind to believe a sharper slowdown in the economy than we are currently projecting – a Brexit break – is still a possibility. It is difficult to know for sure at this stage, but it is possible the election results might have some bearing on the likelihood of such a discontinuity. That discontinuity risk provides a strong rationale for monetary policy not rushing its fences, especially with underlying nominal pressures in the economy still relatively weak.

Second, there is of course the election itself and the dust-cloud of uncertainty that has thrown up about the course of policy and politics in the period ahead. Financial markets-wise, that's manifesting itself most obviously in the exchange rate at present. But who knows how many more twists and turns there will be on the political front over the weeks ahead, with potentially important implications for asset prices and, at least possibly, confidence among businesses and consumers. I do not think that adding any further twist or turn for monetary policy would be especially helpful in this environment, at least until some of that political dust-cloud has started to settle.

So while our August policy meeting is in play for me, depending on how the data and the politics play out, I am minded this month to leave unchanged both Bank Rate and the stock of asset purchases. Thank you.

**Governor Carney.** Thank you Andy, so, Jan and then Kristin gets unleashed, unlimited word count, as many metaphors as you can put in ...

**Kristin Forbes.** You dare?

**Governor Carney.** Yeah! Absolutely! You've earned it. But Jan first please.

**Gertjan Vlieghe.** Thank you. I want to recap briefly how my views have evolved since February, before turning to today's policy decision and outlook. I find this useful in disciplining my reaction function and my interpretation of the incoming data.

In February, after many months of seeing domestic growth momentum holding up and global growth momentum improving, for the first time since I joined the Committee I seriously considered the possibility that policy rates might be too low. But I thought it was appropriate to wait before actually making a change, especially given the asymmetry of monetary policy near the zero bound. I wanted to monitor three aspects of the near-term evolution of the economy. First, whether the start of Brexit negotiations looked promising, and, if not, whether there were signs of any economic fallout on investment. Second, how consumers were responding to a real income slowdown that had only just begun. And third, making sure that underlying inflation pressures remained subdued, which in turn would justify waiting for more news on consumption and investment.

In March, I saw sufficient evidence in the retail sales data that the anticipated consumption slowdown was no longer just in the forecast, it had begun. But a stronger world economy and a weak currency could mean exports and investment would improve. I still worried about whether investment might respond adversely if early signs of negotiations – which had still not started – were disappointing. I noted some uptick in measures of inflation, but wages as well as services inflation remained subdued, and inflation expectations looked well anchored.

In May, I saw more evidence accumulating of a consumer slowdown, and the Q1 GDP release confirmed that it was severe enough to cause an overall growth slowdown. I also acknowledged that, on our central forecast where growth remains around 0.4 after Q1 and wage pressure builds, policy rates in the latter part of the forecast period were likely to rise more than the yield curve implied.

For today's meeting, I will frame my discussion around the same three aspects discussed earlier, namely the consumption slowdown, the investment and export outlook, and underlying inflationary pressure.

On the consumption slowdown, I fear that Q1 was not the trough, despite stronger April retail sales. The downside news on cars dominates the upside news on retail sales. Perhaps we will see a big rebound in car sales in Q3, but for now I note that the drop in car sales after the tax change was much larger than the boost in car sales before the tax change, so I stick to my earlier interpretation that the boost was masking an underlying slowdown already underway. Weakness in house prices

and housing transactions in the past several months adds to my concerns about near-term consumption growth, though I would like to see to what extent London is driving the aggregate.

That leaves the question of whether other components of demand could plausibly offset the consumption slowdown.

The election campaign has delayed the point at which the detailed Brexit negotiations will start. The surprise election outcome is messy in the sense that a minority government is more fragile than what we had before. But the election outcome is also a positive. It seems to me that we were previously on a course that denied the existence of a fundamental trade-off involved in leaving the EU, as well as a deep national disagreement on how to deal with these trade-offs. The election results have made any denial of both of these facts much more difficult.

Investment intentions in the manufacturing sector have meaningfully picked up in the past few months. But investment intentions in services, a much larger sector, have ticked up by less, and only to levels last seen about a year ago, when aggregate business investment growth had already fallen to around zero. On the export side, there is a similar split, with the BCC survey balance relating to goods exports quite strong, but the component related to services exports little changed near five-year lows.

I remain sceptical, on balance, whether exports and investment can make up for the ongoing weakness in consumption growth that I expect to see. My overall take on the domestic activity data is therefore that we have had some downside news relative to the May forecast.

I now turn to the third marker, namely underlying inflation pressure.

The AWE data show absolutely no sign of upward pressure at all. I expect the next headline release of ex-bonus pay to drop below 2%. But as I have stressed before – I did write that before you said it – but as I have stressed before the AWE data is noisy, and I really prefer to look at a broad range of pay indicators. Some are subdued and stable, and some are subdued and slowly creeping higher.

Lining up this wage picture with the unemployment picture remains puzzling. The unemployment rate keeps making new lows, confounding my repeated expectations that it will stabilise.

But some of the details of the labour market quantities continue to look less buoyant than the headline. The ONS measure of underemployment remains well above pre-crisis lows, and has actually risen in Q1. The quit rate turned back down after several years of steady increases, around the same time as workers started to take less leave again, which might be a sign of workers desperately clinging on to jobs they have in the face of uncertainty, rather than feeling they have ample outside options in a tight labour market.

Turning to CPI itself, we have had some stronger numbers. Headline inflation, core inflation, and, within that, services inflation have all moved higher. A key question is whether this configuration means that inflation pressures are spreading beyond just pass-through. Unfortunately, looking at services inflation, even once we strip out airfares, is not a good way to answer that question. Core services inflation, at least in the past, has also shown clear evidence of FX pass-through, so it is not a clean measure of domestic inflation pressure.

My take on the cost and prices news is that it leaves me uncomfortable, in the sense that it is difficult to tell a consistent story that fits all the facts. Subdued wages suggests plenty of slack, but very low unemployment says hardly any slack. Somewhat elevated under-employment, and a turn down in the quit rate and leave taken, suggests labour demand is not as buoyant as the headlines suggest. Rising services inflation seems to point to stronger inflation pressure, but at least some of it is likely to be just pass-through.



The combination of downside news in activity with mixed news in costs and prices still leaves me with no desire for an imminent rate rise. The conditions under which I would change my vote are one or more of the following ...

One, signs that consumption demand is more resilient than I thought, for example a continuation of better retail sales data after the one strong April number, or a stronger car sales rebound in Q3, or a re-acceleration of consumer credit.

Two, signs that other sectors of demand will adequately compensate for the consumption slowdown, for example a more material rise in investment intentions and export-related surveys, spreading beyond the manufactured goods sector, and backed by hard data.

Three, signs that underlying inflation pressure really is building, for example a further grind higher across a wide range of pay-related indicators, with resilient employment growth and employment intentions, or a move higher in longer-term inflation expectations.

It might only be a few more months before such signs become apparent, but that is not my central scenario. There is a substantial risk that the economy loses momentum relative to our May forecast, via a combination of a more severe consumption response to weaker real income, and a dampening effect on investment and exports from a poor start to the Brexit negotiations. If those risks materialise, and underlying inflation pressures remain muted, I would want to wait longer before raising the policy rate.

**Governor Carney.** Great, alright. And now, in her final appearance, Professor Forbes.

**Kristin Forbes.** Thank you.

There's apparently a tradition that a member's last MPC statement should focus on big picture insights learned over the term. And include a poem. I will do the first, but don't worry, not the second.

Instead I will revert to my preferred literary device, an extended analogy. When I started on the MPC, these analogies attempted to show a sophisticated appreciation of UK heritage, with early themes from Shakespeare and Dickens. The analogies gradually became more low-brow with references to Harry Potter, Star Wars and frequent boiling frogs. Today I will take it down another notch: The Chronicles of Saint Mary's. If you haven't read the books, they recount the exploits of a group of academics who travel through time to observe and record major historic events. No matter how well they prepare, they constantly face surprises and unexpected challenges.

There's been no shortage of surprises and unexpected challenges during my time on the MPC. The biggest surprise at the start of my term was productivity growth: why was a pickup elusive, even as the prolonged effects of the crisis had largely faded? We are still processing the implications for potential GDP growth, wage growth, and other issues critical to monetary policy. The biggest surprise recently is wage growth: why is a pickup elusive despite a very tight labour market? We have continually been challenged to set monetary policy during periods of uncertainty around elections, with four major votes in less than three years. We urgently need to improve how we treat uncertainty in our forecasts; our standard treatment would imply a boost to forecast inflation and growth from the sharp decline in our problematic uncertainty measure as of Pre-MPC. Good luck to all of you with that!

Possibly the greatest surprise for me, however, is how monetary policy has evolved over my term. Three years ago, it was widely expected, including by me, that we would be starting a rate-hiking cycle within months. Three years later, Bank Rate has never been increased, and is instead lower. And that doesn't even include the additional easing from £70 billion of bond purchases and a new

Term Funding Scheme. Nine years after the crisis, why has the UK been unable to lift off? And why not for the last three years when growth averaged an above trend 2.3% year on year?

We all know the reasons: the lower natural rate of interest; headwinds from the crisis, including tighter fiscal policy; the series of so-called unfortunate events, ie, lower commodity prices, emerging market concerns, and Brexit uncertainty; and risk management around the lower bound. Each month, there are valid reasons made by Committee members to keep monetary policy on hold, including by me for much of my term. Most months have also included some discussion that monetary policy will likely be tightened sooner than implied by the yield curve, but usually with no urgency to start tightening that month.

Taking a step back, this leads me to my key question: has the accumulation of decisions that the majority viewed as optimal each month added up to a policy stance that is optimal when viewed from a longer-term perspective? If you were one of Saint Mary's time-travellers, and visited the UK when I started my term and then today, would the monetary policy stance make sense?

The time-travellers view of today's economy is informative. GDP growth over the last four quarters has averaged 0.5% quarter-on-quarter, above trend. Although it has been volatile, some of this reflects holiday timings and trade data, with quarterly GDP growth in domestic demand ranging only from 0.48% to 0.57% over the last four quarters. Unemployment is now 4.6%, the lowest since 1975. Although it is unclear where U\* is, there is likely little, if any, slack in the labour market. Headline inflation in May was 2.9%, and core was 2.6%. Credit conditions are very supportive by a host of measures; so supportive that the FPC is likely to begin tightening through multiple levers. This is an economy that by most measures appears to be overstimulated. A time-traveller could make the case that monetary policy should have been tightened at least six months ago, so less stimulus was in place today. Granted, soft wage growth points in the other direction. But, as our time-traveller would quickly remind us, a key lesson from monetary history is that a tightening cycle should start before wage growth accelerates, that's why we spend so much time trying to estimate output gaps.

Of course, this snapshot of today's economy is too simplistic. Monetary policy should be set based on expectations. Today's loose monetary policy partly reflects August's forecast that the Brexit vote would cause growth to decelerate to near recession levels and unemployment increase to 5.6%. Although those forecasts were highly uncertain, the argument was made that if the substantial easing was not needed, and if the sharp deterioration in activity did not occur, we could easily reverse it. It has now been almost a year since the vote. The severe slowdown on which the stimulus was predicated has not transpired. Granted, the Bank's stimulus played a role in the stabilisation and growth has recently softened. But over the three full quarters since the referendum, GDP has increased by three times more than we expected in August, and unemployment is 0.5 percentage points lower than we expected then.

Given this outperformance in activity, why haven't we reduced the stimulus? The main argument continues to be concerns about the future, although the exact concerns have shifted. In August, the concern was that uncertainty would drag on demand; more recently the concern is that the pickup in inflation is eroding real incomes and consumer spending. These concerns are valid, but even if they play out as in our central forecast, they don't necessarily derail the case for tighter monetary policy. Strength in other components of demand is likely to keep growth around potential. Although worker concerns around Brexit may be driving softer quits data and soft wage growth, this is unlikely to continue given the multifaceted evidence of robust labour demand, vacancies at the highest level on record, and growing skill shortages.

The outlook for inflation in the central forecast also supports tighter monetary policy. Inflation is likely to continue to pick up and remain above target for all of the next three years. Inflation is likely to surpass 3% soon, requiring a letter to the Chancellor. My latest update of our shocks-based pass-

through estimates supports our pass-through forecast. Even though the first-stage pass-through to import prices is likely to be less than in our forecast – I estimate ending at about 50% instead of the assumed 60% – the second stage of pass-through is likely to be greater than average, so the net effect we have built in is about right. But domestic cost pressures are continuing to build. As of the end of last week, the variance-adjusted DGI measure was at 2.1% and about half of the DGI measures at or above levels consistent with the inflation target. Staff analysis shows that, with underlying goods core inflation around the expected  $\frac{1}{4}$  to  $\frac{1}{2}\%$ , then headline inflation of 2% is consistent with services inflation of around 2.7% to 2.9%. Services inflation was at 3% last Friday – above that band. And all of these statistics I just cited are likely to be even more worrisome after incorporating tomorrow's CPI release.

The bottom line: both today's data and the central forecast make it hard to justify the substantial monetary policy stimulus currently in place. Of course, there are many scenarios where the situation could change and stimulus could be needed in the future. But there are always risks. And the more widespread recovery in the global economy reduces some of those risks.

Thinking about the evolution of risks over the past three years, I have become more concerned about the asymmetry in our assessments and policy responses. We're much quicker to adjust monetary policy in response to downside risks than upside. We adopted a large stimulus package in August due to concerns that the economy might weaken substantially not waiting for hard data. Then the economy outperformed for much of a year, yet we're still reticent to recalibrate the stimulus. The Pre-MPC graph showing the accumulated, positive UK data surprises since June is striking. Granted, a greater focus on downside risks – and willingness to respond to them – has made sense over the last few years given risks around deflation, the lower bound, and secular stagnation. But these risks have receded and the August package, for me, has confirmed the power of QE as a tool around the lower bound. I find it quite disconcerting that the one year-one year rates have become so much less responsive to positive news surprises that their sensitivity to positive events is insignificant today, the first time since end-2008.

For all of those reasons, my vote on Wednesday will be to remove some of the monetary stimulus in place and increase Bank Rate by 25 basis points. My final strategy recommendation is to encourage monetary policy to be more nimble in the future. When the facts change, it should be easier to adjust monetary policy in both directions.

To conclude, back to The Chronicles of Saint Mary's. In the series, the main protagonist is a female professor, one who holds strong views, approaches things from a different perspective, and regularly challenges her colleagues. She also quickly learns that many trips through time end with scrapes and bruises. One constant through the series though is the importance of the people with whom she works. And this certainly applies to the MPC and broader community at the Bank. I have learned an immense amount from all of you, especially those of you who have often been on the other side of the monetary policy debate. I leave this voyage even more convinced that the best decisions benefit from the insights of a range of people with diverse opinions. At the end of a Saint Mary's mission, the time-travellers repeat the refrain: "it has been an honour and a privilege". And that holds true for me today. It has truly been an honour and a privilege to serve as a member of this Committee. I look forward to dropping in again albeit from a plane rather than a spaceship.

**Governor Carney.** Excellent. Thank you very much Kristin and thanks for all your contributions, both allegorical and, allegorical, statistical, your judgements, your challenges and your comradeship, so thank you very much. A very hard act to follow. I think we will be in a position, the Treasury will be in a position, relatively soon, to try to do it, but I don't envy the individual, whoever it is, who will follow.

Ok, so I'll wrap up with my views and I'm just going to pick up from the May IR and the three judgements that we outlined there: more subdued household spending growth that that would be balanced by a pick-up in other components; secondly, that regular pay growth would remain modest in the near-term but then pick up

significantly; and thirdly that sterling pass-through would boost prices as expected without those adverse consequences for inflation expectations. And I want to just give my take, at least, on the evidence for each as many others have done.

Not surprisingly on domestic demand, evidence is mixed, as always, and in particular with the short horizon. On balance it doesn't suggest an upside risk to our forecast but neither anything too troubling. There are signs that, for me, to me at least, that consumption remains soft and could decelerate further. We had the expenditure split for what its worth for Q1, the car registrations were weak again in May and are now down for the year and I think we can just drop the tax story from our analysis of this. Retail sales did bounce in April after a very weak Q1. Surveys suggest to me at least, a renewed weakness in May and the Visa numbers out today don't dispute that. For what it's worth – and I wouldn't overplay it because they've under-predicted consumption for the last year – but on a longer time series those Visa numbers are actually pretty well correlated with consumption rather than retail sales. In fact they're as correlated as GfK consumer confidence. So I would just, I would put it in the 'it doesn't suggest strength' category, but put some weight on it.

As others have noted, the housing market has slowed more than expected, with prices falling – weakest since September 2012 – mortgage approvals down for three months in a row and lower than our forecast, and I think there was a good due diligence on how much of that was buy to let. It didn't surprise me given the FPC's focus on this, that – given buy to let is only 15% of the flow – it hasn't been decisive, wouldn't be decisive in terms of the slowdown in approvals, although it plays a role. And obviously it does, as others have noted, the weakening in the housing market contrast with the relatively firm activity data, with housing starts on an upward path.

Now more positively, consumer confidence is holding up, despite the squeeze on real incomes, and our judgements on business spending appear to be on track. Business investment growth in Q1 was in line with our IR projections. Surveys support a modest pickup in Q2, financial conditions are more supportive than they were in May, and potentially even more so with sterling down further if it persists. The best news, I think overall on the demand-side, is probably from abroad, where the expansion is broadening and strengthening as projected; it's good to have it confirmed. Growth rates of industrial production and capital orders, goods orders, have fallen back slightly from their peaks at the start of the year but they remain elevated and, as I say, broad based growth, Europe picking up, Japan five straight quarters of growth, US consumers returning to the shops, and on some calculations we have up to 80% of the global economy now growing above potential. So the world appears on track for its strongest performance since 2010. And correspondingly, surveys of UK export growth have picked up further in the past month and point to a faster expansion than we projected in the May IR. So on balance, it remains possible that the recoveries in investment and net exports, on which our projection relies, are coming to pass and could balance out some potentially, some potential signs of a sharper slowdown in household spending, at least for my read.

As for wages, the second issue, and we're all familiar with the further weakening in AWE growth, despite evidence that slack's been used up at an even faster pace than we had expected, it seems that that slack has, on balance, has continued to narrow – even on broader readings – with lower unemployment and vacancies reaching a record high and surveys pointing to continued robust employment growth. I think, just as an aside, I think Kristin's point – when we had our discussion on labour market churn as a possible indicator of Brexit bargaining power, and a potential shift in that, if we see a shift in that, is a good leading indicator – is very astute. On balance of reading the labour market data, I don't yet see a reason to row back from our May IR judgement that there will be a significant pickup in the wage growth over the forecast period; like Dr Broadbent, I am clinging to the Phillips Curve even if it is possibly flattened somewhat.

On sterling pass-through and inflation, we have seen a sharp pick-up in CPI in April and again in May, and also in the core. Like Kristin, Michael, Ian, I note on the indicators of DGI, about half are above rates consistent with the inflation target in the past, or at least rates that have been consistent in the past, and I guess we don't have our updated principle component measure of core, but it did pick up by 0.2 percentage points in April. And I think this issue of potential broader margin expansion is definitely one to watch and

something we really need to drill down as much as possible into the August *Report*; the shorthand would be as Ben and Ian referenced it.

Bringing this all together, I would say I'm more confident about the world, a little less so about the UK, but I view the trade-off as continuing to diminish as slack is eroded faster than inflation – the prospect of inflation fading.

So from a policy strategy perspective, events of the last few days confirm that we remain in truly exceptional times. Now exceptional times had an economic meaning in our remit and still does, but the latest developments in the labour market mean that the trade-off we are facing is becoming less marked and could disappear altogether over the course of the next few years, making the policy decision more conventional. We noted in the May IR that, on the assumption that adjustment to the UK's new relationship with the EU would be smooth, now I would, I'd probably add, on the assumption that the economy behaves as if the adjustment to our relationship will be smooth, because that's the operative issue – it's ultimately, it'll be a few years before we find out how smooth it ultimately is, but at least if agents are taking that view, in that case monetary policy could need to be tightened by somewhat more than implied by the very gently rising path on which the projections then were conditioned. At that point in May, I said that for me that implied tightening might start towards the end of the year rather than in early 2019. I mean it was, it was a pretty modest move. Now, if current trends continue – less slack, firmer DGI and more balanced growth – I see the possibility of bringing that forward somewhat, though not as much to later this week and I would hold off, I would personally hold off tightening later this week for a few reasons.

First, as I mentioned last week, the economy is likely to face some tightening in macroprudential policies later this month, with the FPC raising the counter-cyclical buffer, tightening the leverage ratio and tightening underwriting standards for consumer credit. That's, you know, we will get a staff analysis of that, which says it doesn't matter, I guarantee you we will get that, I wouldn't be so sure, it's a turn, it's a turn in the credit cycle. I did think it did, it mattered in the other direction when they loosened two of the three.

Secondly, once again, we do have some political uncertainty injected into the economic environment. We'll see how long the last few days of uncertainty persist, and I certainly wouldn't want to be handcuffed by it. But I think that underscores the merit in preparing the ground as best we can, for an adjustment in policy, certainly one that's not unanticipated.

Thirdly, Brexit negotiations are about to restart after the election imposed hiatus, with the UK position best described as developing.

And fourth, by August, we will have seen, we will try to divine the first signs of the economy's reaction to that inevitable noise around the Brexit talks, somewhat tighter financial conditions ex-sterling, but have a sense of where sterling is headed. And one hopes, one hopes, a greater recognition of the possibility that interest rates could go up as well as down.

In that last regard, I think the distribution of outcomes has increased with the election result with respect to the Brexit outcomes. But given, but to my mind, given that our starting position is with relatively little slack, the probability of a rate rise across this distribution has increased. So we had said before about supply, demand and exchange rate balance, I can see bad outcomes or more difficult outcomes in the negotiations being consistent with having to raise interest rates and I can see better ones being consistent as well and of course there is a middle path in there, but on balance I would say it's moved in that direction, at least for me. So I would suggest moving the relatively modest nod to balanced risk to monetary policy in the MPS, but we can wait till everyone's voted and people reflect on that and obviously grind through on the MPS.

So, to sum up, I'm minded to vote later this week for no changes in interest rates or asset purchases, but see that some prospect of some tightening has moved forward in time.

So I'm going to try to summarise and I'm going to suggest what certain people said about things they didn't explicitly mention, which is that I took three minded to, in various degrees of mindedness, vote for a 25 basis

point rate increase, Kristin, Michael and Ian, which means, and five minded to hold rates at 25 basis point, Jan, Andy, Jon, myself and Ben. And then not everyone mentioned asset purchases, but I take by exception that everyone will hold the current stock of asset purchases, so eight-nil for both of those. Good ok. Very good, so with that, unless anyone has anything else, I'll ... Ian?

**Ian McCafferty.** One thing, which I didn't mention in my speaking notes for issues of brevity, but I've also, as Ben had at our Discussion Meeting, been thinking more about the balance between moving Bank Rate and unwinding QE as a long-term target. And, while I am strongly in favour of the marginal instrument argument – that we should be treating Bank Rate as our marginal instrument and getting it up to a point at which it could be used in both directions is valid – I also think that there are some counter arguments to do with the flatness of the yield curve, which may suggest that a little more flexibility as to how we think about unwinding would be beneficial. Now there's no hurry for this, but I do think I would support any further work that we could do thinking about all of this and watching the Fed as and when they decide to do something, to inform our future decisions a little bit.

**Governor Carney.** Yeah, that's good, you'd referenced it, you'd reinforced it and I think having a pretty fulsome work programme on that would be very helpful. And I do think that, it would be nice if the Fed, we used to get the Kiwis to do things, let's start with the world's most important bigger guinea pig with the Fed to do it. I think one of the things, one general point is, there is going to be a lot, you know we've had many debates about uncertainty, but there will be a lot of things moving around over the balance of this year and into next, these Brexit negotiations are, they'll generate a lot of noise, but they're extremely complex. We are, pick your euphemism, we could be in a better position, let's put it that way for them. Somebody mentioned fiscal policy, I think Michael mentioned fiscal policy, certainly that would seem to be some potential adjustments there. And we may want to think hard about, I think we should look at this issue but we're going to have to really think hard about public communication around it ...


**Ian McCafferty.** Oh, of course yes ...

**Governor Carney.** So that we are limiting the number, the market's having a tough enough time wrapping its head around the fact that interest rates can move, let alone other things might move, so we'll just keep that in mind as we work through it. So we'll try to have, I think if our view shifts on it, we'll try to have a deliberate cross-Committee type communication ...

**Ian McCafferty.** It's something to be done slowly, but on the basis of the best thinking we can come up with.

**Governor Carney.** Yeah, I entirely agree. Ok. If that's ok? Good. We will adjourn and reconvene Wednesday morning.





A meeting of the Monetary Policy Committee was held on Wednesday 14 June 2017. The following members of the Committee were present:

Mark Carney, Governor  
Ben Broadbent, Deputy Governor, Monetary Policy  
Jon Cunliffe, Deputy Governor, Financial Stability  
Kristin Forbes, External Member  
Andrew Haldane, Chief Economist  
Ian McCafferty, External Member  
Michael Saunders, External Member  
Gertjan Vlieghe, 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  
Alan Castle, MPC Secretariat  
Bob Hills, MPC Secretariat  
Matthew Tong, Deputy Editor of *Inflation Report*

## Transcript of the Monetary Policy Committee Meeting on

Wednesday 14 June 2017

**Governor Carney.** Ok. Good afternoon everyone. Welcome to the Decision Meeting. We'll start off with Ben first on recent developments in financial markets which have been a little punchy and then Andy can just update us on the data.

**Ben Broadbent.** Yeah. I mean overall the changes aren't that big since we met, although there have been some swings up and down in the interim. Sterling is marginally lower and one-year one-year interest rates are also marginally lower; both went up at around the time of the CPI release and fell back by little more after the labour market release. Further out the curve has steepened slightly. Forward rates are up a little bit. MI associates that with the, apparently, with the prospects of easier fiscal policy or the noises about it. UK focused equity prices have fallen very slightly. No move in inflation expectations after the CPI release, except for the contracts directly affected by that number over the next year. That's it.

**Governor Carney.** Ok. Good. Andy, on data.

**Andrew Haldane.** There has been no new significant domestic data beyond what we covered at our previous meeting. Internationally the one thing I'd mention is euro-area industrial production for April which was up 0.5, that was north of expectations. There is also a revision up to the March data. The net effect of which is that the staff have nudged up their forecast for Q2 euro area from 0.6 to 0.7 and that's all, thanks.

**Governor Carney.** Good. Alright, with that, I'll put forward three propositions, the first that Bank Rate be maintained at 25 basis points. The second that we maintain the stock of sterling non-financial investment-grade corporate bonds, financed by the issuance of central bank reserves, at £10 billion. And the third, that the Bank maintains the stock of UK government bond purchases, financed by the issuance of central bank reserves, at £435 billion. And I will endeavour to go in the same order as Monday, so starting with Ben Broadbent.

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

**Governor Carney.** Ok. And then Michael Saunders please.

**Michael Saunders.** I support the propositions on asset purchases, both of them. But on Bank Rate I disagree. I prefer to hike by 25 basis points.

**Governor Carney.** Ok, thank you. Jon Cunliffe.

**Jon Cunliffe.** I vote in favour of all three propositions.

**Governor Carney.** Ok. Ian, ok ...

**Ian McCafferty.** I vote against the first, preferring a 25 basis point increase in Bank Rate, but for the second and third on asset purchases.

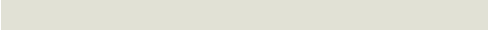
**Governor Carney.** Andy?

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

**Governor Carney.** Jan?

**Gertjan Vlieghe.** I vote for all three propositions.

**Governor Carney.** Kristin?



**Kristin Forbes.** I vote to increase Bank Rate by 25 basis points and support the last two propositions to hold asset purchases constant.

**Governor Carney.** And then I vote in favour of all three propositions ...

So by my count that is five to three in favour of maintaining Bank Rate at 25 basis points, with three votes to increase it by 25 basis points. And eight to nil, or everyone in favour of the propositions to maintain both the corporate bond asset purchases and the gilt asset purchases. Ok? Good.

With that, I'll reiterate the appreciation I stated ... Personally, on behalf of the other members of the Committee, of the staff that's represented here, the people of the United Kingdom and the international economic community for your contributions Kristin and we look forward to remaining in close contact over the, over the coming years. So thank you very much and we wish you Godspeed back to the land of the free and the home of the brave.

And with that, we'll close this meeting and proceed with the Minutes.