



**BANK OF ENGLAND**

---

## **MEETINGS OF THE MONETARY POLICY COMMITTEE**

**March 2017**

---

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

Mark Carney, Governor  
Ben Broadbent, Deputy Governor, Monetary Policy  
Jon Cunliffe, Deputy Governor, Financial Stability  
Charlotte Hogg, Deputy Governor, Markets and Banking  
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  
Simon Hayes, MPC Secretariat  
Sarah John, MPC Secretariat  
Melissa Davey, Editor of Inflation Report

## Transcript of the Monetary Policy Committee Meeting on Monday 13 March 2017

**Governor Carney.** OK, good morning everyone. Before I turn to Andy to see if there are any comments on published data, I've just received the confidential labour market statistics. This will be released on Wednesday, so it will be out in advance of our minutes coming out. It is a mixed bag: downside news on pay, upside news on hours. On unemployment rate, LFS unemployment for the three months to January was 4.7% with a full 31,000 in change of heads. Staff expectation was 4.8%. The average hours worked is up, the outturn is 32.3. That is up from staff expectations of 32.1 hours per week. Pay is disappointing. AWE total pay including bonus decreased to 2.2% from 2.6%. Now obviously bonus is what it is. We had expected, for what it's worth, a stronger increase of 2.4%. Whole economy AWE regular pay growth was also weaker. Staff expectations were 2½% and it's come out at 2.3%.

**Michael Saunders.** That's the single month or the three month?

**Governor Carney.** That is the three month. All of these are three month. And in the advance I don't think we get the breakdown on private sector. Everyone deserves a pay rise; they're just not getting one. Alright, Andy, any comments?

**Andrew Haldane.** Very little, really, since we last met. Internationally the big news, of course, was Friday's payrolls number, which you will have seen; a bit north of expectations at 235,000. Domestically, well last time I think Mark mentioned index of production data for January. We had construction for January, as well, and trade. They were all broadly in line with our expectations and no reason from any of those to change fundamentally our nowcast for Q1, which remains at 0.6%. I think that's it actually Mark, thank you.

**Governor Carney.** Ok. So let's go to indications on the proposition. I'll start with you Ben, and I'll summarise at the end.

**Ben Broadbent.** The world economy has picked up strongly in recent months. The composite PMIs in the US and eurozone are both above average, the latter now at a five-year high. Our updated forecasts have UK-weighted world GDP growing at 2½% annualised though the first half of this year. The nowcast indicators suggest something more like 3%, which would also be the highest for five years. Global equity prices have continued to perform strongly this year.

All this has provided a significant tailwind to UK activity. Indeed, if you run regressions of our own composite PMI on its counterparts elsewhere, and even without factoring in the weaker currency, you'd have expected a rise over the past three months, not the slight decline we witnessed. Notably, that composite doesn't cover the retail sector.

It's not clear, however, that we'll see the same decoupling of official estimates of growth, at least as early as Q1. The nowcast for UK GDP is 0.6%, only a smidgeon below the figure for Q4, and still higher than those projected for the United States and the Euro area.

In part, this reflects the strength of monthly growth through the end of last year. In manufacturing and construction, output fell between December and January, by 1% and 0.5% respectively. But in both cases it was still 1% higher than the monthly average in the fourth quarter. You'd need to see some expansion in February and March to match the quarterly growth rates in Q4, which for both sectors was slightly higher than 1%. But it wouldn't take that much. The stronger world economy is helping manufacturing. Construction has been benefiting from rising housebuilding.

One sector where we are likely to see a sharp deceleration is retail. The ONS bases its early estimate of value-added growth in that sector on the figure for gross sales. And those look likely to fall in Q1. The retail sector's only 6% or so of GVA, but the turnaround could be enough to knock 0.2 percentage points from aggregate GDP growth.

Michael pointed out that this may have been exaggerated by a spuriously strong figure for October. That's true, although I don't think that it can just be that. Retail sales in January were also lower than last summer and have seen their weakest growth over any six month period for three years. Nor can we expect, this year, anything like the near 5% annual growth in retail sales volumes we've seen over that three-year period. If people have been obedient to the Governor's invitation to enjoy

the benefit of falling import prices while they lasted, they will presumably enjoy the cost of rising import prices somewhat less.

Now what that means for aggregate demand is less clear. Even as a guide to total consumption the retail sales data aren't the best. Some are bought by companies. Estimates of household spending are determined ultimately by the Living Costs and Food survey. And if manufacturing and construction continue to thrive, supported by a stronger Europe, a weaker currency and rising housebuilding, consumption growth will only tell you so much about aggregate demand anyway. Relative to our own updated projections outside forecasters appear to have over-weighted the fall in retail sales.

We shall see. Households spend more on services than on goods. If the deceleration in retail spending reflects an income squeeze that spreads only subsequently to other parts of consumption, and perhaps, as Andy suggested, aggregate housing spending will slow, and by more than we expect. If that happens the momentum behind the housing market and housing construction, may also dissipate. It's possible, even if the market is over-weighting the retail data, that we are under weighting it.

All those are just "ifs", however. Our best guess must be that outside forecasts are too weak, as regards near-term growth. And that could help to explain the marked divergence between forward interest rates here and in the US. Growth may not have decoupled but 10-year yields clearly have done.

It's not the only explanation. Longer-term yields in the Euro area have also failed to rise, perhaps because of heightened political risk. And although our updated forecasts have slightly stronger growth than in February, our inflation forecasts are unchanged, partly thanks to sluggish wage growth. Those inflation forecasts are still slightly below consensus over the next year, but now marginally above it towards the end of the forecast horizon.

But I suspect that the decoupling of yields is at least in part because outsiders see the risk of a more abrupt reaction to the Brexit process, even over the next few months, than we have allowed for. It is suggested that the Prime Minister will invoke Article 50 as early as tomorrow. If that were followed in short order by public squabbling about the terms of the divorce it could trigger a more marked and visible reaction by trading businesses.

I don't know whether this is right or not. What is clear is that, in the meantime, trading conditions for those businesses are propitious. The world economy is strong, the currency is weak and market access is, for the time being, completely unchanged. So that increased nervousness is probably necessary for the economy to slow significantly, even allowing for the shrinking contribution of consumption. Without it, the yield curve may be too flat.

That is a matter, as far as I am concerned, for the May forecast; there is still much to learn before then, possibly as early as this week. I envisage this month voting for no change in policy, either rates or asset purchases.

**Governor Carney.** Thank you. So I have Michael and then Jan, please.

**Michael Saunders.** Thank you. For me, a key issue is whether we have correctly calibrated the short run effects on the economy of Brexit and the associated sterling depreciation.

The work by the IMF, OECD and Bank of England staff suggests that, in the long run, Brexit will probably reduce UK potential growth, via reduced trade openness, investment and productivity. Our forecasts assume some linear interpolation of this long-run effect into the near-term growth forecast, so that exports respond less than usual to sterling's depreciation, while investment and productivity growth will remain subdued in 2017. In addition, we assume that pass-through from sterling's depreciation to consumer prices will match its historic norm.

Those were reasonable assumptions in the immediate aftermath of Brexit. However, nine months on, I think it is worth reviewing them.

The full upward effects on inflation of sterling's depreciation still lie ahead. However, it is worth noting that, applying a normal seasonal adjustment program, three month on three month CPI inflation is already running at 3% and core inflation is at 2.2%. And the strength of lead guides, such as PMI output prices, the BoE agents survey of finished goods, import prices, and CBI distributive trades selling prices, suggests to me that pass through to the CPI from the weak pound in coming months may be greater than the *Inflation Report* base case. These surveys mostly measure the breadth, rather than the pace, of price increases. But, in the past, they have been useful guides to trends in the import-intensive components of the CPI.

It is unclear whether these readings signal a bigger total pass through from sterling to tradable prices or merely a faster transmission of the same total amount of pass through. Either way, with the current levels of sterling and commodity prices, I would not be surprised if CPI inflation reaches 3% year-to-year late this year or early next. Even if this is just a case of faster pass through, such an outcome would increase risks of some erosion of our low inflation credibility. Such an outcome would probably also imply a greater squeeze on real incomes and hence, most likely, on real consumer spending than the IR base case.

At the same time, business surveys show a sharp improvement in export orders, and suggest that exports are benefiting more or less as usual from sterling's depreciation rather than the more muted response in our forecast. Moreover, business surveys overall suggest that firms' investment intentions are more buoyant than implied by our forecast and indeed are slightly above average, especially in manufacturing. Reflecting the boost from sterling's depreciation, the share of manufacturing firms citing capacity expansion as a key reason to invest is the highest since 1979, with particularly high readings among larger firms (that is firms with more than 500 employees) and also in the food and drink, and motor vehicle sectors. Investment spending additionally may be supported by the strength of corporate profits. The ratio of private non-oil corporate profits to GDP in Q3 of last year was back to the Q1 peak. This ratio has not been higher since 1999. And the profit to GDP ratio probably rose further in Q4, given what we know about aggregate profits in that quarter.

Productivity growth also picked up in the second half of 2016, although it is too soon to tell whether this is a sustained breakout from the recent weak trend. In particular, the Q4 gain in productivity may have been somewhat erratic, given that it seems to have benefited from an unusually sharp mismatch between stronger output growth and weaker employment in financial services. So, at this stage, I am not convinced that the recent strength in productivity will be sustained. But, at the very least, there is no sign yet that the Brexit vote is hitting productivity growth. This may be consistent with the signs that the Brexit vote also does not, so far, seem to be reducing trade openness, given that trade openness often is a key driver of productivity gains. And there is some anecdotal evidence from the agents that firms are responding to the low jobless rate and Brexit-related uncertainties over the availability of foreign workers by looking to lift productivity through labour-saving investment or changes in internal structure.

So it may be that the probable long-run adverse effects of Brexit on exports, investment and productivity – affecting both the supply-side and demand-side – will come through more gradually than we have expected. Of course, all this may tell us very little either way over the long run effects of Brexit.

But the implication of all this is that we may get higher near-term inflation coupled with a greater rotation of growth away from consumer spending and towards investment and net trade than in our base case.

So where does this leave monetary policy?

I argued last month that there is a reasonable case for a modest near-term rate hike, to reverse part of the easing made last August. That easing was made in anticipation of a sharp slowdown in growth and rise in unemployment which, in practice, has not occurred. The economy grew a little above trend in the second half of last year and, on the staff forecasts, continues to grow a little above trend in the first half of this year. The retail sales data and BRC survey hint at downside risks to consumer spending growth. But, as we discussed, and as Ben just mentioned, there are reasons to not rely too much on the retail sales data as a consumer spending guide. Moreover, it seems to

me that there are upside risks to exports and investment that may maintain overall GDP growth roughly in line with our forecast even if consumer spending disappoints slightly.

The modest pace of wage growth reinforces the judgment that the output gap probably has not yet closed. Nevertheless, with the jobless rate now matching the lows of the last 40 years, slack is probably modest rather than large. And our base case implies that slack will shrink further in the first half of this year.

Against this backdrop, I believe that policy should remain somewhat accommodative for now. But, as I said last month, I question as to whether we should have our foot quite so firmly on the accelerator. The current policy stance is highly accommodative and seems likely to produce a somewhat undesirable trade-off, with above-target inflation and, in the near term, continued above-trend growth that pretty much closes the output gap. Such an outcome could well lead to a significant erosion of our low inflation credibility which would then make it much harder for subsequent tightening to be only limited and gradual.

A 25 basis point rate hike would still leave a very accommodative policy stance, helping to support growth and keep unemployment low. If the economy continues to grow steadily, an early hike would prove a timely first step that should allow subsequent rate hikes to be relatively gradual. If the economy does unexpectedly turn down sharply, there would be ample scope to loosen again.

If I was fully certain of the new upgrade to the growth forecasts, without a corresponding upgrade to potential growth, I might well vote for a hike this month. But I see little cost to waiting a brief period to see more data, given uncertainties over prospects for both growth and productivity. So I will probably vote for unchanged policy this month. For me, this is a finely balanced decision.

**Governor Carney.** Thank you Michael. Jan and then Jon please.

**Gertjan Vlieghe.** Back in November, we started discussing the gap between the way households, firms and financial markets seemed to view the medium-term impact of Brexit on the economy. Households seemed decidedly on the optimistic end of the spectrum, judged by their spending. Financial markets were on the pessimistic end of the spectrum. And businesses were somewhere in the middle: not as bad as we had feared, but clearly not particularly buoyant given roughly zero investment growth and investment intentions that were consistent with more of the same. We discussed how the gap might be closed by households reducing spending growth, or by financial markets re-pricing the exchange rate and domestically focused equities.

Until recently, neither had happened. The trade-weighted exchange rate remains around 13% below the pre-referendum level. And the prices of domestically focused equities have underperformed US and continental European markets by a similar amount. Consumption, on the most recent ONS data, continued to grow at a pace close to 3%.

Starting in late January, however, the data related to household demand turned more mixed, after a period of systematically surprising us to the upside.

Car sales are still strong. Housing indicators and consumer confidence remain resilient, but are nevertheless down from their autumn post-referendum rebound. The CBI and BRC retail surveys came markedly off their highs, consumer credit is growing more slowly, and retail sales data itself has been downright weak.

At first, the gap between weak retail sales on the one hand, but strong car sales, resilient confidence and housing data on the other, bothered me. I thought of it as an inconsistency.

But, upon closer inspection, it troubles me less. Car sales and confidence are a good early indicator of consumption when there are drastic changes to consumption. But for more moderate slowdowns, they are less informative. For housing market activity, there is a link with consumption, but, since 2008, the relationship has been somewhat closer with overall GDP than with consumption, as there have been significant swings in housing investment over the period.

So what about retail sales? As the staff pointed out, the correlation with consumption is low. But a strong correlation requires both a stable lead-lag structure, and a stable beta – i.e. how much does one move if the other moves by a given amount. That is a lot to ask of the data. Using that standard, the answer to “how much does indicator X tell us about indicator Y” will usually be “very little”.

Instead, I ask the following question: when the three month on three month growth rate of retail sales turns negative, as it has now, how often does consumption slow in the nearest or the next quarter? The answer, over the past ten years, is eight times out of eight. Over the past twenty years, it is 11 times out of 13. So I think that it is highly likely that consumption is now slowing.

Of course, a slowing in consumption was in our forecast. The question is, how much is consumption slowing, and how long will it last? For that, it is still too early to draw any conclusions. But it is significant, for me, that the slowdown in consumption is no longer just in our forecast.

And with inflation set to rise further this year, eroding real income growth further, it is more likely that the slowdown will intensify, than that it will turn out to be short-lived.

It is also the case, as the staff pointed out during Pre-MPC, that the slowdown in GDP is not just about consumption. It is possible that net trade or investment improve sufficiently to offset the consumption slowdown. I have been impressed by the strength of some of the export-related indicators. It seems that exporters are able to take advantage of the weaker currency so far, despite the uncertainty about future trading relationships. The outlook for investment, on the other hand, remains subdued, looking at a range of indicators of investment intentions.

The stronger export-related indicators are probably not only driven by the currency. There has also been, in the second half of last year, a significant upswing in global growth indicators across the US, eurozone, emerging markets and commodity prices, as we have factored into our February forecast. Global risks remain, and we all know what they are: US protectionism, eurozone elections, the sustainability of growth in China, and the potential fallout of a stronger dollar and higher US rates on emerging markets. But despite these risks, the data have improved markedly.

On the growth outlook, my conclusion is that consumption is now slowing, the investment outlook is little changed, and the central outlook for net exports is probably stronger than I had thought a few months ago, though downside risks to the international outlook remain.

Turning from growth to slack and inflation, the labour market data continue to confound, with unemployment falling faster than I thought, but still absolutely no sign of upward wage pressure. I think, subject to data noise, that wages tell us about labour market slack. So it suggests to me that lowering  $u^*$  to the extent that we did was entirely the right call. On the upside, I do note the uptick in indicators of domestically generated inflation. But I also note that services inflation, even adjusted for the drag from university fees, remains subdued and well below historical averages. And I take comfort from the stability of break-even inflation since the rise back to normal last October.

What does all that say about the appropriate stance of monetary policy? Last month, I laid out several reasons why, despite stronger growth momentum, I still thought it was appropriate to leave monetary policy unchanged. I will lay out those reasons again.

An asymmetry in our ability to ease significantly versus our ability to tighten and the likelihood of a very low trend real interest rate, make me more cautious than I would otherwise be when considering tightening monetary policy. In such an environment, a tightening which turns out to be premature is a more serious mistake than a tightening that turns out to be somewhat late.

In particular, I want to avoid tightening prematurely when there are clear near-term downside risks:

- (1) Brexit negotiations are about to start, and there is a risk that if they do not go well, and with a two-year deadline now looming, it might affect business investment more severely than has been the case so far;
- (2) consumers now do seem to be responding to the real income slowdown, which has further to run;



(3) looking beyond our borders, while there will always be an election somewhere, the French elections seem both important enough and soon enough to take seriously as a macro-economic risk now.

This cautious strategy only remains valid while underlying inflation pressures remain subdued, providing evidence that there is still enough slack in the economy to be able to tolerate the pass-through driven inflation overshoot. The recent evolution of wage-related indicators and services inflation, and the stability of inflation expectations, suggest to me that this is still the case.

**Governor Carney.** So I had Jon and then Andy please.

**Jon Cunliffe.** Thank you. One of the benefits of going to eight meetings a year is that the mid-forecast meeting now provides a better opportunity to take stock. And the key for me is how the economy is developing relative to the February *Inflation Report* forecast.

So if we start with the more backward-looking data. The ONS's second estimate revised up headline GDP growth in Q4 to 0.7%, 0.1 percentage points stronger than expected in the February *Inflation Report*. And household consumption, which we have said we are watching closely, grew by 0.7% also in Q4. That is in line with the February *Inflation Report*. Elsewhere, business investment was weaker than expected, data caveats notwithstanding, but housing investment and net trade were stronger. Overall, the expenditure split was broadly in line with what we expected in February. So, looking back, I would say the economy was a bit stronger than we were forecasting.

Turning to measures more closely related to current output, industrial production fell a bit in January but that was broadly as expected. Business output surveys have been a mixed bag but the overall picture they paint at present looks solid. The Markit/CIPS services output index fell further below its historic average in February, while the broader Markit/CIPS composite output indicator also fell, though it remained around its long-run average. CBI Service Sector Survey, however, showed a robust increase in reported output in the three months to February to around its historic average. Turning to manufacturing, the EEF Manufacturing Outlook reported the output balance increased sharply in Q1 to its highest level since Q3 2013; and the latest CBI Monthly Industrial Trends showed broadly unchanged manufacturing output, but it remains significantly above its historic average.

So overall, the relative strength in official output data and output surveys taken together have led the staff to increase their near-term growth forecasts by 0.1 percentage points in Q1 and 0.2 percentage points in Q2 relative to where we were in February.

Turning to more forward-looking indicators, output expectations surveys also remain solid though, as with the output surveys, the manufacturing and service sectors paint somewhat different pictures. The Markit/CIPS composite expectations indicator fell in February, though it remains around the long-run average; the CBI Service Sector Survey showed a material increase in expected output. On manufacturing, the CBI Monthly Industrial Trends expectations balance reached its highest level since September 2013 and the Q1 EEF Manufacturing Outlook expected output balance increased sharply to its highest level since Q2 2014 and considerably above its historic average.

Surveys focused on individual components of demand seem consistent with the pattern of demand in the February IR. Business investment intentions remain muted but largely unchanged. Export surveys remain strong.

On the household side, consumer confidence hasn't shifted much – for example, the GfK/EC consumer confidence survey was unchanged in February. And the housing market – another proxy for consumer sentiment – is evolving broadly in line with our expectations. The average of lenders index recorded three-month house price inflation of 5.6% in February, which is a bit lower than we were expecting in the *Inflation Report*. Mortgage approvals in January were nearly 70,000, which is slightly above what we are expecting.

The one indicator that has moved materially is retail sales. The official retail sales data is the biggest, and at present the only, straw in the wind that a consumption slowdown may be coming. Volumes have fallen for three months in a row. Annual BRC volumes growth has also fallen significantly.

This is – as I said – only one straw in the wind. Everything else seems to be in line with the February *Inflation Report* or a bit stronger. And well known caveats apply, most notably that retail sales don't correlate well with consumption expenditure.

It could be that retail sales data tell us more at turning points in inflation though that's somewhat speculative. I do put a little weight on the fact that the largest falls in retail sales have been food and fuel sales, the two components where recent inflation has been the highest. This might suggest that retail sales may be a better leading indicator of consumption in the face of sharp increases in prices, as Andy pointed out last week.

But overall, I don't see any strong evidence yet to suggest the economy will diverge materially in either direction from the February forecast.

Looking beyond the UK, there are forward-looking indicators of a pickup in the global economy. Global PMIs reached their highest level in two years in January. But as we discussed, for me it remains to be seen whether the survey strength translates into underlying momentum.

Given that the economy looks broadly on track with the February IR the key issue is domestically generated inflation. We are seeing a build-up of inflation in the pipeline, for example in producer price indices, but that's mainly the imported inflationary pressure we have, for the present, taken a decision to look through and I don't think we should double count until we have better information on either the speed of pass-through or the level. So are we seeing second round effects?

Well, the ONS measure of core inflation was a touch weaker than we expected at the time of the *Inflation Report* at 1.6% and other measures of core inflation remain subdued as a whole.

Pay growth was also slightly weaker than we expected in the latest data. Total pay growth fell to 2.8%, 0.3 percentage points weaker than expected, whole economy total and regular pay growth were also both weaker than expected in the February IR and the swathe of measures of pay growth shows no obvious signs of an imminent pay surge and today's figures I think have confirmed that picture. So pay is not flashing red. Not for the first time it has disappointed us a little and then disappointed us a little more.

And likewise although the latest unemployment rate was slightly lower than expected in the *Inflation Report* the weaker relationship between unemployment and pay has consistently surprised us over the past few years. The outlook for the output gap and inflation has not moved much in the staff's mechanical forecast update relative to the February IR.

And finally, on inflation expectations these remain pretty much in the same range. Having increased in the months following the referendum, particularly after the Prime Minister's October speech, UK five-year five-year inflation swaps have fallen by around 15 basis points since the February IR to around their post-crisis average. There has been a pickup in long-run household inflation expectations but these are now back to their past averages. There are no 'warm' cells in the inflation expectations heat map for households or corporates.

That said, headline inflation has not yet moved above target and there are some warmer cells on the heat map concentrated on medium-term inflation expectations of professional forecasters and of financial markets. So although inflation expectations continue to look well anchored, they require close monitoring.

Overall, though, I see no compelling evidence of undesirable second round effects.

Finally, a word on risks around output. I think both upside and downside risks are elevated but the tail of the distribution is fatter for downside risks for two reasons.

First is the well-trodden point about policy risks at the zero lower bound. Put simply, given where we are, I am more confident about the effectiveness of tightening than of loosening policy.

And the second downside risk relates to Brexit. There is a risk that emerging evidence of a bad outcome leads to a sharper break in business and consumer confidence. This would probably lead to a material fall in demand. I cannot see an equal upside risk to confidence from Brexit over the policy horizon.



To wrap up, I don't think there is a strong reason to change my view of how the economy is likely to evolve. And given that assessment, I intend to vote to leave Bank Rate and our asset purchase programme unchanged.

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

**Andrew Haldane.** Thank you Governor. Since the [publication of the]<sup>1</sup> February *Inflation Report*, sterling interest rates have fallen by around 20 basis points across the yield curve. Forward rates are back down to levels seen last November. Financial markets now do not fully price the first rate rise until the third quarter of 2019 – which is four quarters later than at the time of the *Inflation Report*. Interest rates are not expected to reach 1% until 2022. And they peak at 1.8% in 2030.

Having never been below 2% before 2009, markets now do not expect them ever again to reach that lowest-ever level. Economists' views are not too dissimilar with the majority of those polled in the latest Reuters Survey not expecting a rise in Bank Rate before the end of 2018.

So for all the talk of a global reflation, there is precious little evidence of that in the current sterling yield curve. There is greater evidence, of course, in the US yield curve. Financial markets expect interest rates to hit 1% later this year and to hit 2% by the second half of 2019.

As Charlotte discussed, that leaves the US-UK bond yield differential, at a ten-year maturity, at almost 150 basis points, its highest level since 2000. These yield curve wedges between the UK and US, both at the short and long end, are on the face of it difficult to explain using prevailing macro fundamentals.

The output gap is estimated to be small, at around ½%, in both countries. Unemployment is within spitting distance of its natural rate in both countries. CPI inflation is close to 2% in both countries, as is output growth. And wage growth remains around 2½% in both countries. These macro-fundamentals are striking in their similarity, not their difference.

If we were running a Taylor rule for the UK and US, and if we assumed both countries had similar  $r^*$ s – a big if of course – it would be difficult to justify any wedge between current UK and US interest rates. Yet if, as seems likely, the US raise rates later this week, that wedge in policy rates will already be around 50 basis points.

Some of the explanation for the widening wedge in market rates can perhaps be found in the expected paths for inflation and the output gap in the period ahead. Our February *Inflation Report* projections suggest that output growth in the US will pick up to 2.3% this year and next and the output gap will turn positive, reaching 0.8% by early 2019, by which time the CPI inflation rate will be above 2% in the US.

If we fed these projections mechanically into a Taylor rule, with equal weights on the output and inflation gaps, it would imply around 90 basis points of tightening over the next two years, even without any change in  $r^*$ . And, voila, the dollar yield curve currently also implies around 90 basis points of tightening between now and early 2019. This is, of course, materially less than most FOMC members expect over the same period; they expect a close to 250 basis point rise in US rates, perhaps reflecting their view on rising  $r^*$ .

If we turn to the UK, putting our own updated projections for the output gap and inflation through a Taylor rule would imply around 40 basis points of tightening over the next two years. Whereas the yield curve currently implies less than one rate rise over that same period. In other words, based on this simple Taylor rule arithmetic, the unresponsiveness of the sterling yield curve poses something of a puzzle.

What might explain this yield curve unresponsiveness and the UK/US differences more generally? Well, one factor is perhaps fiscal. The UK and US are now set on quite different fiscal courses. Over the next two years, the UK will undergo a further net fiscal contraction of around 1% of GDP, while the US is expected to deliver a net fiscal stimulus of around the same amount. However, to the extent these fiscal plans are already reflected in growth forecasts, they are unlikely to explain much of the UK/US difference.

---

<sup>1</sup> Added by the MPC Secretariat for clarity.

A more plausible explanation is that markets are simply looking through the exchange rate-induced overshoot in UK inflation, in a way simple Taylor rules, of course, cannot. Our own statements about extending the horizon over which inflation is returned to target may have encouraged this perception, albeit tempered by our "limited tolerance" for persistent inflation overshoots.

A third factor, and for me perhaps the most plausible of all, is the possibility of a sharper, discontinuous adjustment among UK consumers and/or companies as the expectations gap with financial market participants is closed.

Some of that downside risk is already visible in financial markets, whose implied probability of a policy loosening over the next year or so is around 50-60%, although professional economists put the probability much lower than that.

The possibility of a sharper-than-expected adjustment in spending also poses a challenge to our monetary policy communications and policies. If the economy could be relied upon to behave roughly linearly, then I think there would be a strong case for bringing forward, perhaps materially, the expected date of lift-off. Indeed, tighter monetary policy could be seen as one of the mechanisms enabling and smoothing the downward adjustment in households' income and consumption plans.

But doing so is complicated by the fact that, first, consumers might well not adjust their plans smoothly and linearly; and, second, our actions could themselves be the catalyst for such a non-linear response by consumers and companies.

For what it is worth, the evidence so far does not suggest a discontinuous response by either consumers or companies is imminent. With housing, credit and confidence all holding up, there is still a firm underpin to consumer spending and company hiring. Firm-level surveys point to continuing robustness in activity through Q1 and into Q2, at around historic average growth rates. That has caused staff to revise up their GDP forecasts for this year, to above 2%, and to push back to later in the year the point at which any slowdown commences.

Nonetheless, my own sense is that there are enough straws in the wind to suggest that the adjustment by consumers has already begun in earnest. Moreover, that adjustment appears to be taking place in pretty much the way we had expected, namely courtesy of an import price-induced squeeze on purchasing power and thence spending. The categories of spending where we would expect these effects to show up first – namely, food, drink and fuel – are the ones which have tended to exhibit the greatest weakness over the past few months.

That explains the downside news in retail sales, or a good chunk of it, and is one reason why this indicator may at present contain more leading indicator information for future consumption than past statistical evidence would imply.

Meantime, there is nothing on the nominal side – whether from wages or prices or inflation expectations – that at present gives me any particular cause for concern, with all coming in shy of expectations over the month. At the same time, however, I still find it difficult to explain the extent of the recent fall in the sterling yield curve based on this news. And, given the extreme flatness of the curve, this still leaves me concerned financial market pricing may have lost touch, if not with reality, then with the possible upside risks to reality that lie ahead if global deflation gathers pace. A steady-state interest rate below 2% means markets must be assigning an extremely low probability to global deflation ever finding its way to these shores – in my judgement, too low a probability.

In that light, I would support using MPC communications to apply a bit of upward impetus to the sterling yield curve at some point soon. The language here would need to be clear and strong enough to have some impact – our attempts to do so in the past have, if anything, perhaps been a bit too subtle to have their intended effect. At the same time, we need to avoid a tantrum or bringing forward the lift-off date too far. Although I do not envy the drafters their task, I think sending such a single ought to be feasible and from my perspective, and despite my continuing to worry about the possibility of a sharper than expected adjustment in spending, it would also be desirable.

Nonetheless, in terms of today's policy decision it is an easy one for me, which is that I am minded to leave unchanged both Bank Rate and the stock of asset purchases. Thank you.

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

**Ian McCafferty.** It is becoming a feature of the post-referendum environment that, within just a few short weeks of publishing a full forecast, we start to agonise over how far it has been knocked off course by the data news. At one level, this is the most practical illustration of the large uncertainties inherent in our recent forecasts. At another, it does lead to a lot of soul searching.

But while there has been a lot to ponder this month, I find my judgement about the trade-off, the risks around that trade-off, and therefore the appropriate policy position hardly changed from last month.

Starting with the economic data, any shift in the trade-off relative to the full February forecast depends critically on how one interprets the signal-to-noise ratio of each of the new pieces of information. On balance, for me, this month, that signal-to-noise ratio appears slightly higher on the demand side than it does for the outlook for costs and prices, but for both there are significant uncertainties in interpretation.

In terms of demand and output, there are few signs that the momentum in the economy we saw late last year has yet dissipated. Indeed, there are some signs that we might be receiving a little more impetus from the external sector than expected in early 2017. First, in terms of the international background, the staff believe, rightly in my view, that growth, particularly in Advanced Economies, is a little stronger than previously assumed. Second, UK exports appear to be responding strongly to the depreciation, suggesting that Brexit headwinds to increasing exports are at this stage slight, so that the contribution from net trade to GDP in the forecast might be slightly greater than assumed.

In terms of domestic demand and output, the survey evidence continues to hold up, suggesting that GDP growth in Q1 and into Q2 is likely to be similar to the rates of late last year. But, how far might the retail sales data be the canary in the mine? There are a number of arguments based on the disaggregated data that Andy highlighted in Thursday's discussion that could suggest that retail sales could be telling us something important, but, on balance, I need more evidence to be fully convinced. At this time of year, retail sales are notoriously volatile, even on a three monthly comparison, contributing to the relatively low correlation between retail sales and total consumption. For now, the range of other consumer data suggest that spending on non-retail items, confidence, purchasing intentions, and the housing market all seem to be holding up. Michael has also pointed out that there may be some statistical anomalies in the retail data, stemming from the coverage of sales by small retailers. Cross-checking the retail sales data with changes in real consumer income is at this stage difficult, as the Q4 national accounts income data are not yet available. More partial estimates, from employee compensation or AWE and changes in employment, give slightly conflicting signals as to the degree of squeeze in real disposable income in Q4. On balance, therefore, while it is quite likely that some of the recent weakness in retail sales is likely to be idiosyncratic, we cannot ignore the likely signal of some slower consumption growth to come, as the income squeeze tightens.

On the inflation side of the trade-off, I am less convinced of the news value of the most recent data. The slight undershoot in the CPI data derives from two of the most volatile components – clothing and airfares – such that I am uncomfortable fully locking in that 0.1% reduction into the STIF. Meanwhile, on the wages front, the fourth quarter is a quiet period for settlements, such that it remains to be seen if the modest undershoot in AWE growth will persist. The information contained in the Q1 2017 data will be much more informative, and I prefer to wait for that.

As a result, and in spite of all of our individual and collective pouring over the data, I find it hard to justify any material shift in my trade-off calculations relative to last month. I still believe there are more upside than downside risks to our inflation profile over the next 18 months and remain close to the limits of my personal tolerance for that overshoot. If the economy were not to slow, or if domestic inflationary behaviour were to start to manifest itself, my tolerance would be quickly exhausted. But for this month, I am minded to vote for no change in our policy stance.

But if our (or perhaps just my) interpretation of the recent data, and its implications for our forecast, is not unreasonable, both the gap between our latest forecast and those of external forecasters, and the recent moves in the gilt yield curve, leave a certain sense of puzzlement.

Some of the differences with external forecasters probably stem from timing, as survey-driven upward revisions to Q1 and Q2 GDP have probably yet to be fully incorporated, and these will make a significant difference to the annual average growth rate calculations. Externals might also be placing greater weight on the retail sales data, or expect faster pass through, and hence a sharper, earlier hit to consumer spending.

In terms of the gilt yield curve, I find it hard to justify the move since our last meeting, unless our IR forecast is seriously awry, which is always possible, but does not look likely. In the run up to the February IR, we were already concerned by the positioning of the yield curve, but it is now some 10 basis points lower by Q1 2020 than in the IR conditioning, and lower still than on the day of our February policy announcement itself, when we felt it had attained a slightly more reasonable level.

When drafting our last set of Minutes, we spent a good deal of time crafting a message designed to consolidate that rise in the yield curve immediately before our rate announcement. Well, clearly, either the market did not pick up that signal, or it did not believe it. Some of the recent decline may be explained by the difference between our 2017 outlook and that prevailing amongst external forecasters, but I also worry that the simultaneous publication of the IR and the Minutes made it difficult to absorb all of the information at the same time, that the narrative in the IR about more slack became the key story, such that our messaging in the Minutes was overlooked.

With the Fed now in tightening mode, and the US yield curve increasingly converging on the dot plots, I would expect there to be some steepening in the gilt curve in future months. We could simply let this happen when it will, but if others share my concern with its the current position, I would suggest some signalling in this month's Minutes, uncomplicated by the publication of an IR, to indicate our continued unease with recent moves. As I suggested last month this should be a tap on the shoulder rather than a punch in the arm but I think it would be a helpful signal.

So, to summarise, my policy judgement remains similar to last month. I remain close to my trade-off tolerance limits, but there is insufficient information to make any material shift. Looking to the May forecast, if the momentum in the economy does not show any unequivocal signs of slowing and the yield curve remains at today's level, I will be facing a very tricky judgement. But for this month, I am minded to vote for no change in Bank Rate nor in the level of asset purchases.

**Governor Carney.** Thank you Ian. Kristin and then Charlotte please.

**Kristin Forbes.** Another MPC round, another upgrade to the short-term outlook. In four of the last five MPC rounds, the forecast for current quarter and next quarter GDP growth has been upgraded. The slowdown that we forecast last summer has not occurred, even as winter ends and the buds blossom.

Yet, despite two seasons of predominantly positive UK economic news, unease about the outlook continues. This primarily reflects Brexit. Uncertainty around Brexit and the outcomes of the negotiations will fundamentally affect the economy. Nonetheless, monetary policy should continue to be set based on the same principles as in the past: our target and individual assessments of the outlook for key economic variables, including how they affect any monetary policy trade-offs. Today my comments will follow this approach, focusing on the economics instead of Brexit – a variant of Jon's "I had a dream" from last month. Although I prefer to think of it as "not losing sight of the forest for the Brexit trees."

So what does the forest of the UK look like? When viewed from a high level – an eagle's view – the forest appears to be healthy. February's CPI inflation was likely very close – if not exactly at – our 2% target. Our latest forecast update – albeit partial and mechanical – suggests quarter on quarter GDP growth will slow moderately, but remain a solid and above trend 0.6% through the first half of 2017. The expected start of the sharp slowdown has been pushed back, yet again. Unemployment, instead of rising after the vote, has continued to fall to 4.7%, with survey data showing no evidence of a deterioration soon. For people such as me who view this as around the equilibrium unemployment rate, this suggests little slack today.

But what is particularly striking about this eagle's view is that the economy has remained solid despite a Brexit climate change. Brexit has affected the economy – most notably in sterling's 17% fall since November 2015 – but not had the chilling effect many predicted. Instead, there has been a

moderate warming. As I discussed last month, the UK economy has performed as well or better by almost all real indicators than expected before the referendum, based on a remain vote. Granted, some of this strength undoubtedly reflects monetary easing and a stronger global economy. But some also reflects greater UK momentum and resilience.

This eagle's view is important when thinking about monetary policy. Given little slack, above-trend growth, and inflation expected to pick up sharply and be above target in three years, why is monetary policy not tighter?

The answer is concerns about future growth and unemployment. Ever since August, we have been expecting the economy to begin to weaken in the next quarter. This was a key part of why the MPC eased monetary policy last summer, albeit with different views on how much easing was required. And even though this easing was expected to coincide with inflation overshooting target, high inflation could be tolerated due to the expected trade-off with weaker growth and higher unemployment.

Now we have information on how the economy has responded and evolved since. And an "eagle's view" tell us that both sides of the monetary policy trade-off have changed since August. I will begin with the inflation side of the trade-off, then the unemployment/growth side, before netting them out.

The outlook and risks for inflation are clearly worse than in August – even after accounting for the weaker than expected CPI and AWE data available at Pre-MPC. In August, we forecast that inflation would peak at 2.4%. In our March update, we forecast that inflation would peak at 2.7%.

More striking is the shift in the DGI data. In the data available for our August MPC meeting, the 10 DGI measures that I follow averaged 1.3%, and only 2 of the measures were above 2%. In the DGI data available Friday, the average has picked up to 1.9%, and 6 of the measures are about or above 2%. Granted, in the past DGI measures averaging about 2½% were consistent with inflation at target. But this is no longer a useful benchmark because this coincided with a period of negative core goods inflation – which is unlikely to be repeated in the near future. Staff analysis shows that underlying core goods inflation is now more likely to be around ¼% to ½% in the future, in which case headline inflation of 2% would be consistent with services inflation of around 2.7% to 3.0%. Service inflation (currently at 2.6%) is almost there today.

I also view the upside risks to inflation relative to the forecast as substantially higher today than in August. The global economy and global inflationary pressures are stronger. The most recent forecast incorporates a 0.6 percentage point lower assumption for U\* – despite little change in the relevant variables since August. And although wage growth has slowed, there is even more uncertainty than usual about where it is heading. The standard deviation in the wage measures in our swathe is now 1.3 percentage points – about twice the average dispersion since 1998 and about the peak during the crisis. Given the low unemployment rate, and increased difficulty attracting workers from the European Union, wages could well pick up faster than forecast.

On top of this, price pressures at the early stages of the supply chain have accelerated sharply. For example, the CBI, Markit/CIPS, and EEF manufacturing survey all show sharp accelerations in input prices and output prices – with most indices reaching or even exceeding the highs seen around 2010/2011 when inflation peaked at 4.7%. When this price acceleration is combined with a much tighter labour market than during 2010/11, this substantially elevates the upside risk to inflation.

The bottom line – the inflation side of the trade-off is worse than in August for several reasons.

What about the other side of the trade-off? I have already discussed how unemployment and growth have been stronger than expected. But is a slowdown simply coming later? Various measures of retail sales have softened over the past month. Although these data have a high noise-to-signal ratio, the preponderance of evidence suggests that some softening in consumption is underway. This softening, however, currently only appears to be moderate, due to support from solid consumer confidence, solid house prices, and easy access to cheap credit – as well as other consumption indicators which have not softened as much. There are risks consumer spending could slow more sharply – but to date – these are still just risks.



It is also important to put any consumer softening into context – back to seeing the forest for the trees. This is a slowdown after consumption continually beat expectations – even higher in the second half of 2016 than we forecast in May assuming a remain vote. If consumption growth had continued at this pace, supported primarily by increased household borrowing and lower savings, this would have elevated other risks.

Moreover, a moderate slowing in consumption growth is still consistent with our forecast for solid GDP growth and employment. It is likely to be partially counterbalanced by net exports, a healthy rebalancing that already appears to be occurring. The pickup in the global economy should further support this rebalancing, especially when combined with sterling's depreciation.

The bottom line for this side of the trade-off: no deterioration in unemployment and growth yet, and substantially less deterioration in prospect than previously expected.

Tying this together, both sides of the monetary policy trade-off have materially evolved since August. Inflation is already accelerating faster – while the deterioration in unemployment and output continues to be “in prospect”. The outlook for above-target inflation from 2017 onwards that we would need to tolerate has deteriorated since August. On the other side, the outlook for unemployment and output has improved, providing less justification for tolerating inflation above target over the next three years. Both sides of the trade-off have evolved to point policy in the same direction.

Therefore, in my assessment, it is now time to recalibrate the amount of support for the economy provided by monetary policy. At Wednesday's vote, I am likely to vote to increase Bank Rate by 25 basis points. I am also likely to vote to carry on with our corporate bond purchases and maintain our stock of gilts – both of which will continue to provide monetary policy support for the economy during these uncertain times. Even though I did not support the two asset purchase programmes in August, I would prefer to tighten monetary policy by increasing Bank Rate as I continue to believe that this is the optimal tool for marginal adjustments in monetary policy.

To conclude, I realise that adjusting monetary policy today would have risks. Even if the economy slows moderately as expected, the MPC could be criticized for causing a slowdown that was already in train. There are many other risks to the current forecast. But these risks will continue for an extended period – including those around Brexit. Monetary policy should not go on hold due to these concerns. If anything, we should be more nimble and more willing to adjust our individual assessments of the monetary policy trade-off as new information comes in during this period.

I have never liked the way that the press categorises each of us as a type of bird. But maybe we need a new category to add to the hawks, doves and Minouche's owl: an eagle. During politically challenging times, it is even more important for us to be birds that fly well above the Brexit trees in order not to lose sight of the forest.

**Governor Carney.** Thank you very much. And now we have Charlotte and then me. So Charlotte please. Welcome.

**Charlotte Hogg.** Let me start by saying on the record how pleased I am to have joined the Committee, and thank you all very much for your welcome. I very, very much appreciate it. These are strange and uncertain times, not just in our country but beyond. Every generation seems to face their own set of unprecedented events and these may well be ours. Navigating through successfully will be the responsibility of many, primarily of those who we elect. But the MPC can help by fulfilling its remit.

My analogy for this meeting, if you will forgive me the indulgence, is of a steamship's boiler. Standing on a muddy East Midlands field this weekend, a friend told me the story of his great grandfather who was a ship's engineer (before being a cowboy, gold miner and infantryman). His great grandfather, manning the boiler of a steam ship warned the captain that the boiler was being pushed too hard and the ship would blow up. Commanded to fire the boiler he jumped ship and sure enough learned later that the ship did blow up.

Our remit helps to maintain a steady firing of the ship's boiler. Doing so requires all of our best judgements and analytical rigor, and I hope to bring to our debates a different perspective, grounded



in private sector experience in retail and wholesale banking serving consumers and businesses. I also hope to bring the best of the work we do in Markets and Banking to support the Committee, whether it be market intelligence or in our own operations.

Although I have watched Pre-MPC from the stalls many times, Wednesday was my first time sitting on the other side of the table. The thing that struck me most was the disparity in perspectives between financial markets and consumers. In a seemingly pessimistic view of our long term prospects outside the EU, the exchange rate has fallen by 18% from its peak and the gap between US and UK long term interest rates is now wider than at any time since the MPC was created. But consumers don't share this pessimism. Or if they do, they haven't yet allowed it to affect their spending. The result of these divergent views is that the economy is still steaming ahead, smoke puffing out of the chimney, a steady pace maintained.

But ultimately the disparity in these views between financial markets and consumers will have to be reconciled. The pistons are not quite in sync, the heat isn't quite even in the boiler. If I have interpreted it correctly, the best collective judgement of the Committee is that this reconciliation will largely come about via an eventual slowing in consumption growth as the weakening of real income growth becomes increasingly apparent. Business investment and net export growth will not be strong enough to prevent the economy from slowing overall. In turn this slowing will keep a lid on wage growth, ensuring inflation will return to target once the effect of the depreciation has passed through.

These seem the right set of judgements to me. What's more, I don't think the data news in the weeks since the *Inflation Report* was published is significant enough to mean any of them are off track. We can now be more confident that there is momentum in global growth – some coal is still being shovelled into the boiler. The big picture on consumption and business investment seems little changed. Wage growth has turned out a little weaker than expected, but the reality is the news is probably too small to have a material impact on our forecast. That's all the more true given our discussion of non-wage cost growth. If pension auto-enrolment is resulting in weak wage growth, for example, it is not a sign of weakness in total labour cost growth. Auto enrolment is not yet fully rolled out, and our contributions are set to continue rising across all businesses of all sizes.

So – to eliminate any lingering suspense – I don't intend to vote for any change in policy this month. I'd like to spend the next few minutes setting out which of the boiler gauges I plan to be particularly focused on over the coming months. Two of these relate closely to the judgements the Committee has already highlighted in the final paragraph of the February Monetary Policy Statement. The other is additional.

The first is higher frequency indicators of prospects for consumption. To date consumers have only managed to maintain their spending by dipping into their savings or increasing their borrowing. This is an inherently fragile source of growth – I know from retail financial services that the difference between managing ok and financial distress is a very narrow one. I also know that sentiment can change quickly, particularly in a world where news travels fast across social media. Echo chambers can cause actions to ripple through segments and groups. For all its flaws as a predictor of consumption, the sharpness of the fall in retail sales is difficult to ignore. And there are signs that the monthly growth of consumer borrowing is cooling and for me the product characteristics in unsecured lending are eerily reminiscent of the 2005-06 period.

An intriguing new measure of consumer confidence posted on Thinkspace this week corroborates the idea that households' behaviour is indeed beginning to change. Using three million customer searches for insurance and loans, Money Supermarket collates a measure of consumer confidence based on various indicators of household 'animal spirits' including: the average voluntary excess on car insurance; the proportion of homes undergoing building works; etc. Interestingly, this measure of consumer confidence held up when others fell sharply immediately after the referendum but it has weakened of late, suggesting that worries about the future are beginning to build.

The second thing I will be paying close attention to over the coming months is business investment. Of course this was not amongst the main judgements highlighted by the Committee in February, and reasons of data reliability alone mean that was probably a wise decision. As I begin to familiarise myself with the data on business investment – and the scale of the revisions to it – what strikes me is

how difficult it is to get a good handle on what is currently going on, let alone what will happen in the future.

But difficult as it is to measure accurately, business investment will play an important role in determining the aggregate path for GDP in the coming years. In my experience, businesses are adept at making the best of the situation in front of them, and as I dig deeper into the data I will be particularly alert to signs that they are simply getting on with things. My questions will focus on what type of investments these are – whether we are seeing investments that focus on nearer term paybacks, likely around automation and efficiencies, that would make sense in all climates, or whether we are seeing major capital investments that represent longer term commitments and longer term paybacks. In that vein, I was interested to hear from the agents that some projects previously put on hold pending a post-referendum review are now being resumed, and I look forward to tracking their evidence closely.

The third thing I will monitor closely is inflation expectations. Together with developments in pay growth, the evolution of inflation expectations will be a key factor in determining whether the path we are plotting for inflation to return to target is a credible one. Given my particular responsibilities for market intelligence at the Bank, I intend to follow movements in market-based measures of inflation closely. Although these measures have risen in recent quarters this is not something I am concerned about. The move brings market-based measures of inflation expectations to a level broadly consistent with historical averages. But it is of course something we will need to monitor, and I will endeavour to make sure you all receive a clear message on the signal we should take.

To sum up, my initial thoughts as an MPC member are probably as you might expect: a commitment to fulfilling the remit; the ability to see risks to both sides of the projection; and a hope that I can learn more to illuminate my policy choices as I dig deeper into the data. I look forward to keeping you informed. Thank you again for your welcome. My overalls and tin hat are on and I am watching the gauges.

**Governor Carney.** Thank you very much. I can assure you that that is the first time the steam ship boiler analogy has been used, and not the last. OK, good discussion.

In the February IR, we all judged that the stance of policy remained appropriate given our view of how demand, supply and the exchange rate – and hence inflation – would evolve. And we signalled that the outlook would depend particularly on three judgements:

- first, that regular pay growth would remain modest, consistent with the Committee's updated assessment of the remaining degree of slack in the labour market;
- second, that household spending growth would slow as real income gains weaken; and
- third, that the lower level of sterling would continue to boost consumer prices broadly as expected, without adverse consequences for expectations of inflation further ahead.

In the spirit of Ian, I think it's important that, having set out a framework, we stick to it. So what have we learned over the past six weeks about those judgements?

Starting with wages, we framed our judgement in terms of AWE growth, as we are reasonably well-sighted on the outlook for non-wage costs – such as National Living Wage, pension auto-enrolment etc, as per the discussion led by Ben the other day. And also given that productivity data revisions make initial estimates of ULC growth too unreliable.

The data in December was softer on the margin for both whole economy and private sector and the miss in January is further still. We're at least 0.3 percentage points lower on both whole economy and private sector regular pay growth and to a bigger extent, for what it's worth, on bonuses – and I don't think it's worth that much in bonuses quite frankly – relative to the February IR. The survey evidence, however, is more mixed. But overall I think it's safe to say that the data's not inconsistent with modesty, either in growth of wages or in forecasting. We've learned that lesson.

With respect to consumption, everyone has rightly been through this, and so I'll just read into the record my take. There are signs in the hard data – notably retail sales – of an earlier-than-expected deceleration. As you know, retail sales volumes fell 0.3% in January, a third consecutive month of decline leaving three-

month-on-three-month at its weakest since November 2013. And the last time that retail sales declined for three months in a row was January 2010. The in-house estimate of retail sales volume from the BRC release fell further in February. And both indicators suggest quarterly consumption growth in the first quarter is likely to be around half of what we had incorporated in the February IR. I'm not sure it's worth that much, but the monthly tick down in consumer credit is again not inconsistent with this falling from 1.6 billion per month of growth to 1.2 billion on average across December and January.

More neutrally, the Agents' survey of retailers, conducted between late-January and late-February, suggests growth in sales volume could halve over the next year, so something that is consistent with the slow-down in consumption growth in the February IR. And, as others have noted, there are broader indicators of household spending, which are better correlated with consumption growth and these remain broadly consistent with our forecast in February, notably the GfK consumer confidence.

On balance, my judgement would be, on current evidence, there's some early downside risks to our December judgement of moderate slowing in consumption growth, and not much evidence of upside risk to it.

There's little news on the third judgement as one would expect. CPI inflation was 1.8% in January, 0.1 percentage points lower than expected, but that downside news was accounted for by the particularly noisy components of clothing, footwear and services, excluding airfares.

Measures of inflation expectations, to my reading, are little changed on the month and broadly consistent with pre-crisis averages and being well-anchored.

So on the basis of the limited evidence thus far, the three main judgements remain intact. In other words, at the core of the framework, there are no obvious upside risks.

In the periphery, however, there are. Most notably, global momentum appears to be spreading. US surveys have ticked up strongly, with the prospects of tax reform and deregulation providing a sizable boost to animal spirits. Activity is also strengthening in the euro area, although obviously near-term political risks there remain.

The near-term outlook from staff's perspective also looks more robust in the UK than was anticipated a month ago. Q4 GDP revised up and interpretations of output surveys suggesting growth at, or a little above, its historic rate for the first half of the year.

If consumption growth is slowing a little more than projected in February, as others have noted, the most likely source of additional momentum is net exports, buoyed by strengthening world demand and the lower exchange rate. Consistent with this – but quite frankly it's just gratuitous to mention it because it's wholly uninformative – goods export data came in stronger than expected. That's a decent number. But it's useful because it adds a little substance to that statement around net exports.

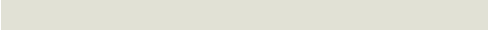
So what does this potentially mean for policy strategy?

Our remit requires us, when faced with exceptional circumstances, as we are now, to balance the speed with which inflation returns to the target with the support provided to jobs and activity. And the new remit in the most recent Budget retains this emphasis.

Recent developments do not yet, to me, support a material change in the likely path of policy from that implied in February: that is, some modest withdrawal of stimulus beginning later this year.

So it is somewhat unwelcome that the yield curve has moved down over the course of the past month by, depending where you measure it, around 15 or 20 basis points – 20 basis points by year three. And that looks too soft, given the outlook. It seems that others who started with a more pessimistic outlook than the MPC have become even more so with recent data. As Andy noted the other day, the gap between us and them is unusually wide.

Moreover, the longer the momentum in the economy is maintained, the stronger the case for responding to that strength and the inflationary pressures that would accompany it. In our framework, the trade-off becomes more conventional with less under-utilised capacity and fewer unemployed.



As we discussed last week, the policy path could be tighter than the February conditioning path if the reconciliation between household strength and financial market weakness takes longer to occur. Tighter policy is also warranted if prospects of a better deal between the UK and the EU results in stronger demand growth and higher inflation, by underpinning consumer confidence and releasing significant pent-up investment demand. Relatedly, signs that stronger net exports are having their traditional investment accelerator effect would also be particularly notable. And I might just say parenthetically I've not seen signs of that yet, but they may come.

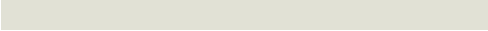
So on balance, even though I don't see any need to move now, in other words I'm minded to vote for no change to either rates or the stock of asset purchases, I do see some merit in, as per Ian, in reminding others something to the effect of first that some monetary stimulus would be withdrawn under our central expectation for the economy and inflation; that our key judgments remain broadly intact; if recent strength of UK economic momentum persists, the trade-off will become more straightforward lowering our tolerance for an inflation overshoot.

This message, and this is the tough part, this message shouldn't be a sledgehammer – a tap not a punch as you said. And we need to take great care not to pre-commit.

But with the imminent triggering of Article 50, now is a good time to remind that there are a range of scenarios where interest rates rise slightly over the negotiating period, particularly if negotiations are perceived to proceed relatively smoothly and constructively. And that the timing and degree of any reduction of monetary policy stimulus will depend, in part, on how the current strength of household demand and the relative weakness implied by many UK financial asset prices, particularly the exchange rate, is reconciled.

For what it's worth.

OK, good discussion. I'll just summarise, actually, and these are indicative or "minded to". By my count we had 8-1 minded to vote for no change in Bank Rate, with Kristin minded to vote for a 25 basis point increase. And 9-0 voting in favour of no change to the asset purchase programme. Right, OK? Good.



A meeting of the Monetary Policy Committee was held on Wednesday 15 March 2017. The following members of the Committee were present:

Mark Carney, Governor  
Ben Broadbent, Deputy Governor, Monetary Policy  
Jon Cunliffe, Deputy Governor, Financial Stability<sup>2</sup>  
Charlotte Hogg, Deputy Governor, Markets and Banking  
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  
Simon Hayes, MPC Secretariat  
Sarah John, MPC Secretariat  
Melissa Davey, Editor of Inflation Report

---

<sup>2</sup> Jon Cunliffe was unable to attend the meeting on 15 March owing to other official business. He communicated his vote to the Governor, and the Committee, in accordance with the provisions of paragraph 12 of Schedule 3 to the Bank of England Act 1998, agreed that he should be treated as present at the meeting for the purposes of sub-paragraph (4) of paragraph 11.

## Transcript of the Monetary Policy Committee Meeting on Wednesday 15 March 2017

**Governor Carney.** OK, so welcome everyone. The first thing I would like to do is to inform you that Jon Cunliffe, as you may know, is attending the G20 in Baden Baden and therefore unable to attend this part of the MPC meeting. He has informed me of his voting decision on the propositions that I'll put forth in a few moments, and he's authorised me to relay his voting decision to the meeting when it comes to vote. Given these facts, I have taken advice from our Legal Directorate. They have concluded, subject to the Committee's agreement, that Jon can be considered to be present, notwithstanding his obvious physical absence, and be able to vote at the meeting in line with the requirements of the Bank of England Act 1998 and that, under that Act, just as a reminder, paragraph 12 of Schedule 3 says that "The Committee may... determine circumstances in which a member who is not present at, but is in communication with, a meeting, is to be treated... as present at it." And I think you're familiar that we have a few precedents for this scenario. So if I may ask for your concurrence with that? Let's go around, everyone's nodding, everyone concurred. OK, so we'll deem Jon as present and I will go through that at that point. So why don't we start. Charlotte if you could just update us on recent market developments since our last deliberation meeting.

**Charlotte Hogg.** I just wanted to briefly note a couple of things. Firstly, sterling ERI has fallen by 0.9% since the Pre-MPC data cut-off last Monday. Market contacts noted that the timing of the moves has not necessarily coincided with any specific news, but come against a sort of series of ongoing political developments. Yields moved higher internationally following relatively strong US market data releases last week. These data were thought to reinforce a now near certain market-implied expectation of a US rate hike today. In Europe, the ECB was also perceived as sending a marginally hawkish signal regarding the near-term outlook for monetary policy last Thursday. Taking all this together, short-term rates in the US and euro areas have increased on the week. 10-year US Treasury and Bund yields have also risen by 10 basis points relative to the data shown at Pre-MPC. These international moves are thought to be dragging UK rates higher. The 3-year UK OIS rate is 8 basis points higher, while the 10-year gilt yield is 3 basis points higher over the period. Finally, oil prices have fallen by \$4 (-7.4%) relative to the data cut-off. Market contacts suggest that the fall was principally driven by a reaction to a US report on Wednesday last week, which showed higher US crude oil stock piles, and some increase in the US oil production rate. The Brent crude spot price is currently \$51.

**Governor Carney.** Good, thank you. Andy, data ...

**Andrew Haldane.** Internationally, industrial production data for the start of the year in, for example, the euro area and China is confirming that pattern of pretty robust demand globally in line with other indicators. And then domestically, the Governor covered the labour market statistics last time. The only thing I'd add is we did have the announcement among one of the big six energy providers, SSE, of a significant rise in electricity prices of almost 15% taking effect towards the end of April. As a result of that, our STIF inflation forecasts between May and July have all been nudged up by around 0.1 percentage point. That's all, thank you.

**Governor Carney.** OK, good. Alright. Everyone has that. And if there are no further questions, I'm going to propose that Bank Rate be maintained at 25 basis points, that the Bank continue with its programme of sterling non-financial investment grade corporate bond purchases totalling up to £10 billion, financed by the issuance of central bank reserves, and that the Bank maintain the stock of UK government bond purchases, financed by the issuance of central bank reserves, at £435 billion. And I'll look to go in the same order as we discussed last time, and that means starting with Ben.

**Ben Broadbent.** I vote to yes to both propositions.

**Governor Carney.** Yes to all three, if you wouldn't mind.

**Ben Broadbent.** Yes to all three.

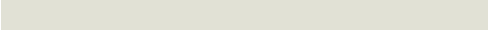
**Governor Carney.** OK. Michael?

**Michael Saunders.** I vote yes to all three propositions.

**Governor Carney.** Thank you. Jan?

**Gertjan Vlieghe.** I vote yes to all three propositions.





**Governor Carney.** Thank you. And, yes, La La Land, exactly as you said, Ian. Jon's letter said, "As you know I'm unable to attend the MPC Decision Meeting on Wednesday 15 March due to being away on official duties. I am therefore writing to confirm my vote for Bank Rate to be maintained at 25 basis points, the Bank of England to continue with the programme of sterling non-financial investment grade corporate bond purchases totalling up to £10 billion and the Bank to maintain the stock of UK government bond purchases at £435 billion." So that is yes to all three propositions from Jon. Right, Andy?

**Andrew Haldane.** I agree with all three propositions.

**Governor Carney.** Thank you. Ian?

**Ian McCafferty.** I vote in favour of all three propositions.

**Governor Carney.** Kristin?

**Kristin Forbes.** I agree with the two propositions on asset purchases, but vote to increase Bank Rate by 25 basis points.

**Governor Carney.** Good, thank you. Charlotte?

**Charlotte Hogg.** I vote yes to all three propositions.

**Governor Carney.** OK, and then I vote yes to all three propositions. So by my reckoning, subject to your confirmation, we have 9-0 in favour of the two asset purchase propositions, and 8-1 in favour of no change to Bank Rate, with Kristin voting for a 25 basis point increase in Bank Rate at this meeting. Alright, very good. Now that is confirmed. And so we will now turn off the tapes and in a moment go down and do the Minutes.