MEETINGS OF THE MONETARY POLICY COMMITTEE

May 2017

A meeting of the Monetary Policy Committee was held on Friday 5 May 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
Sarah John, MPC Secretariat
Simon Hayes, MPC Secretariat
Robert Hills, MPC Secretariat
Melissa Davey, Editor of Inflation Report

Transcript of the Monetary Policy Committee Meeting on

Wednesday 10 May 2017

Governor Carney. Alright, morning everyone. Let's get going, start with Andy to provide an update on recent data just received.

> **Andrew Haldane.** Thank you, Governor. So, internationally, I think the only piece of data I would mention since we last spoke was that Jon touched upon the Q1 euro-area GDP data, which was a bit shy of our expectations. We have had the final estimate of the PMIs for the euro area, which meant we were a touch stronger – that's one of the reasons why our expectations are for some further pick-up into Q2. And then, domestically, we have had another full breakdown of the PMIs for April and the slight nudge-up in the composite was mirrored across all the sub-components – manufacturing, construction and services. That's on the output side; the expectations were, if anything, a touch weaker. And then, finally, we had new car registrations for April, which is quite a striking fall, actually. At least a chunk of that seems to be a timing effect, with registrations and sales brought forward to March ahead of tax changes taking effect. Whether that counts for the fullness of it I think is a bit more questionable. It's hard to draw a trend to this picture, this line, but it's probably down. Thank you.

Governor Carney. Yeah, ok, good. Alright, thank you Andy and nothing on that. Alright, I will ask people to set out their preliminary views and start with Ben and then go to Ian.

> **Ben Broadbent.** Thank you Governor. The forecast we're publishing next week is slightly stronger than others', both for the UK and the UK-weighted world economies. Relative to outside forecasters we are, in some sense, corroborating the US interest rate curve a little more than we are those in Europe, possibly including our own. I will say more about that later. Let me start, as usual, with a summary of the important non-UK data.
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> On the whole they've been reasonably positive. In the United States, the estimate of first-quarter growth was only 0.2%, and that is generally accepted to be a temporarily low figure. Consumption growth, which at 0.1% was the lowest quarterly figure since 2009, is judged to have been depressed by the delay in tax rebates, and possibly by other erratic factors such as the weather. Government spending fell and inventory investment turned negative. Neither of which will last. Estimates of fixed investment, both in housing and by businesses, were very strong. Survey indicators were also firm, consistent with growth of close to 1%, though it should be said that these have significantly over-predicted official estimates of US GDP growth for most of the past two years. Our forecast for Q2 is 0.8%.
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> In the euro area official estimates of GDP growth have been closer to the surveys, it grew 0.5% in the first quarter, slightly faster than last year's average and only a touch below survey indications. Surveys predict faster growth in Q2 – we expect 0.6%. That strengthening is broad-based across the region. Notably, the composite PMI in Italy was the highest for a decade in April, since before the financial crisis.
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> There was less improvement in emerging markets. Survey indicators of output growth weakened in China. And commodity prices, particularly that of oil, have fallen back quite sharply. In sterling terms, taking account of the appreciation in the exchange rate, the Brent price this morning is 19% lower than at the time of the February *Inflation Report*. Much of that has occurred very recently – the price is 13% lower than the conditioning path in this *Inflation Report*.
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> As I said, out forecasts for the world – the UK-weighted world in particular – are more optimistic than the consensus number. Much of that has to do with the projections for the euro area. But relative to the recent past these forecasts don't seem to me to be that tall an order. Euro-area GDP has risen by 1.8% in each of the past two years; our forecast for annual growth peaks at 2.2%, requiring something of an acceleration – though not that much of one – over the next year. Our explanation, for that acceleration, which seems reasonable to me, has to do with a continuing recovery in credit growth and an alleviation of political risks even if they remain. Taking as given our forecasts for the current quarter – in other words washing out the temporary US weakness in Q1 – growth of UK-weighted world GDP will have risen by 2.5% over the past year. In the draft forecast, the figures for the next three years are 2.6%, 2.4% and 2.1% respectively. This relies on sustaining trend capacity

growth at around what we estimate to be its current rate and also for that continuing cyclical recovery in the euro area. Neither is assured, but nor are these forecasts outlandish, I think, given current policy in the euro area. Indeed, even a continuation of current growth rates in the US and Europe – and they've been very close over the past couple of years – might arguably require some convergence between forward interest rates in the two regions.

In the UK, the economic data have been mixed but, on balance slightly softer than we expected in February. GDP growth in Q1 was 0.2 percentage points lower than we'd forecast. The consumption indicators in particular have weakened significantly: retail sales fell sharply and also ended the quarter on a weak note; car sales, to which Andy referred a moment ago, rose in Q1 but they too fell back significantly in the latest monthly release, for April and I think it's more than just a timing thing, a correction of the March figure. House prices are flat; judging by the volume of mortgage lending, the volume of housing transactions is declining slightly. I take Michael's point that, in terms of sequential growth, we may already have seen the steepest rate of decline in real household income. But the correspondence between income and consumption growth isn't that great at such high frequencies and there may be ground still to make up – even after Q1 it looks as though consumption will have outgrown household income over the past year. And real income growth will remain pretty weak through this year given current rates of wage growth. So I think we can, at the very least, expect another contraction in distribution output, which is not covered by the PMIs, in the second quarter, and I also think our consumption forecast for the rest of the year looks reasonable.

The more positive indicators have been for other areas of demand, exports and investment. These are both smaller and more import-intensive than consumption, so they have to grow quite quickly to make up for weak growth in household spending. And of course quite often they do. That's why, all else equal, depreciations are net positive for demand even if they're bad for consumer spending.

But these are also the areas of demand, investment in particular, most prone to the Brexit process. For my part I think you can already see evidence of this in the weakness of capital spending last year. We are allowing for some recovery in 2017. Current levels of investment are low relative to both the stock of capital and to corporate profits, particularly in the tradable sector of the economy. The surveys also point to growth. And if the UK and EU can agree on a new trading relationship, and an extended transition to it, it seems to me there would be little reason not to raise capital spending.

But that agreement is far from assured. The risk of something more disruptive helps to explain, I suspect, why the UK yield curve is as flat as it is. It's also one of the reasons why our forecast, conditioned on that yield curve but a smooth Brexit, involves slightly above-target inflation in the latter part of the forecast. In that sense if reflects a combination of two things that are probably incompatible with each other. As such, and given that domestic cost growth is still pretty subdued, I do not feel any urgency to respond to that above-target forecast by tightening monetary policy right now. And I therefore expect to vote next week both for unchanged interest rates and an unchanged stock of purchased assets both gilts and corporate bonds.

Governor Carney. Ok, Ian and then Jon, please.

Ian McCafferty. There has been a lot to chew over this month, and I feel we have had a very rich set of discussions around the forecast. While I am, by and large, happy with the forecast we have ended up with, it leaves me with a judgement on the appropriate policy stance that is not straight forward.

In terms of that new *Inflation Report* forecast there are a number of key features that have a bearing on my policy stance so I will briefly touch on each.

First, the international outlook: I agree with the upgrade to global activity, for which recent evidence – the pickup in world trade, firmish non-oil commodity markets, the broad-based nature of the revival in activity as well as signs of renewed confidence – all chime with a narrative that the world economy is finally starting to reawaken after its long post-crisis slumber. The global reflation story, if you like. I can find several explanations for the improved outlook – financial system repair, a lessening of post-crisis risk aversion, the fact that the capital replacement cycle is now starting to work in our favour and reduced uncertainly as both the recent transitions in the US (that of the change of president and that of the shift by the Fed to a tightening cycle) have been managed without upheaval in financial markets.

It is not a big turning point for the world economy but it does look to be stepping up a gear. And I am sympathetic to the argument that when the world economy moves in a relatively synchronised, broad-based manner, the feedback loops often generate a little more momentum than we often think. But for this forecast we are right to be modest in our upgrade – we have seen false dawns for the global recovery before, and, although the recent news has been positive, the big event risks with significant negative connotations – disruptive European elections, Chinese debt sustainability as well as possible conflict in North East Asia or the Middle East – remain as potent and as unpredictable as they have been.

The improved International outlook, when combined with the lack of any evidence that Brexit is so far generating any constraints to the UK's ability to export, makes me comfortable with the adjustments that we have made in the IR forecast to our UK demand profile, with the slightly firmer contributions from net exports and investment offsetting the more cautious consumption profile.

But it is in the domestic economy that the main conundrums lie. For me, there are two key issues that will determine whether our forecast proves accurate.

First, are we taking the right signal from the slowdown in both Q1 retail sales and GDP? I believe our forecast treatment of taking Q1 at close to face value and using it as an indicator for Q2 is the best we can do. But there is a high degree of uncertainly around this and good arguments for both alternatives – that Q1 overstates the degree of the slowdown underway or that it presents a harbinger of a more significant consumer retrenchment to come.

On the one hand, the weakness of retail sales appears backed up by the softening of recent housing activity which suggests that consumers may be becoming more cautious about committing to major purchases. But on the other, the latest CIPS Survey for April saw a strengthening in activity in all three sectors pointing to some rebound over the second quarter.

And as we know, the preliminary GDP data are prone to largish revisions, with the mean absolute revision between the initial estimate and that of three years later of about 0.25 percentage points. Statistically, that means that at the limit Q1 could have seen either no growth or no slowdown!

My second key issue is the outlook for inflation. As a result of the adjustments made at the draft meeting I am happier with our projections for the output gap, but individually would have gone perhaps just a little further. Given the recent data on total hours worked, encapsulating both a further fall in unemployment and a sharp increase in individual hours as workers shift from part-time to more full time activity – I am of the view that the current effective output gap is likely to be a little less than the 0.5 percent we agreed for the start of the forecast, such that with the same slope it is likely to close somewhat earlier.

Nor does the recent evidence of weak wage settlements dissuade me from this view. With employers facing sharp rises in non-wage labour costs in 2017 and 2018, and recent settlements responding to the weaker activity at the turn of the year, it is not surprising that adjustments to basic pay remain subdued, although we will have to see whether they recover a little into the second quarter.

When I add to this some concerns about; A) our forecasting record on inflation; B) the potential signal from the two recent CPI data overshoots; and C) not placing too much emphasis on the recent sterling reversal, I retain my bias from the February forecast that the balance of risk around our inflation profile remains a little to the upside.

So to my policy judgement.

If I had a reasonable degree of certainty about my two key issues – the signal from Q1 and the inflation outlook – our latest forecast would, for me at least, justify a pretty immediate start to the reversal of the stimulus that we put in place last August. We portray and economy in which the GDP slowdown is only modest, such that with only moderate productivity growth the output gap is all but closed by the end of the forecast horizon. In which inflation not only remains above target throughout that horizon, but is also no longer moving directly back to target just beyond that horizon. Our trade-off has shifted further in an uncomfortable direction, and is right at the limit of my tolerance by year two and above it as it all but disappears by year three. This is even more true given my concerns about the size of the output gap and the upside risks to inflation.

But the one factor that inclines me towards to staying my hand just a little longer is the remaining uncertainty about those two key issues. By the time of our next meeting in mid-June we will have a much better read on activity in the second quarter and, equally importantly, we will have the CPI data for both April and May which will show whether the recent faster-than-expected pickup is sustained through and beyond Easter.

In terms of this month's decision, therefore, I see little cost and quite some benefit in waiting just a little longer, but it's a very close call. Subject to the data news it's probable that I will want to begin voting for a withdrawal of some of the stimulus that we injected last August as early as our June meeting. And in terms of my vote this month I am keen to hear others' arguments before making a final decision.

If others are coming towards similar conclusions, we will, I believe, need to put some serious thought into our communication strategy. Ben made two telling comments at our Deliberation meeting; one, how little our recent comms have moved markets; and, two, how low market expectations have become in terms of a possible rate rise at any point this year. If others on the committee are similarly minded about the likely policy path I strongly recommend that we provide some unmistakable guidance of the possibility of an earlier-than-expected rate rise in this month's minutes to limit the chances of surprise.

Governor Carney. Ok. There was a bit of cake and eat it too there, we've got to be careful on that. Jon and then Kristin, please.

Jon Cunliffe. Thank you. In the February forecast we expected to see a consumption-led slowing in growth in the near term due primarily to a squeeze on real incomes and also weak business investment growth due to elevated uncertainly. So, what have we seen since then? The preliminary estimate of Q1 GDP growth was 0.3% that's 0.4 percentage points weaker than growth in Q4. And the back casting model suggests that Q1 growth will be revised to 0.4% which is 0.1% weaker than our February forecast.

Official estimates of retail sales have fallen sharply, with three month on three month growth slowing to -1.4% in March – one of the largest quarterly declines in the history of the series. Annualised house price inflation fell back to 2.4% in Q1, that was 3.7 percentage points weaker than expected in February and followed a rise of 6.7% in the three months to December. Mortgage market activity has also fallen back a bit. Approvals were 2.5% lower in Q1 than we had in the February IR forecast. And business investment fell by 0.9% in Q4, again weaker than we expected in February. So there are signs in the hard data for me that the dynamics we expected in February are starting to kick in and, if anything, kicking in faster than we expected.

In terms of other indicators overall, the softer data are not pointing to a stronger outlook than in February. Nor are they signalling a sharp fall-off in growth. The Markit/CIPS composite output indicator rose in April to above its long-run average. But the expectations composite fell again for the third month in a row and remains below its long-term average.

Taking those together, those data are consistent with the staff's Q2 GDP nowcast of 0.4%. Consumer confidence has been fairly flat and remains above its long-run average and consumer credit has continued to grow robustly.

Looking ahead, cumulative GDP growth in the May forecast is broadly similar to what we had in February. But the profile is somewhat different with stronger business investment and net trade and weaker consumption growth in the near term.

I'm content with that forecast profile but I just want to mention a few risks to it.

First, we are expecting business investment growth to improve in the near-term in line with the survey measures of investment intentions which strengthened in Q1. There are downside risks. We are now entering a period of higher and more worrying noise around the negotiations that could in my view affect investment with very short horizons. And the stronger world growth that we forecast will support investment is partly based on soft indicators which have poor predictive power for growth over longer horizons.

Second, although headline inflation has been stronger than expected there are for me fewer obvious signs that either underlying or imported inflation or inflation expectations are any stronger than expected. Measures of domestically generated inflation don't all point in the same direction, but my reading overall is that these pressures remain subdued. The first principal component of DGI is currently below its target-consistent level by about 0.7 percentage points. And annual unit labour cost growth – one of the more theoretically sound proxies for domestically generated inflation – is likely to slow to just above zero in Q3.

The first stage pass through from the exchange rate depreciation has been weaker than expected. Since the last quarter of 2015 sterling world export prices have increased by around 20% while import prices have increased by only 7%. Now it's too early to say if this is a lag rather than a more persistent slower or lower pass-through, but it's something I think we need to watch carefully.

And finally, inflation expectations overall have moved up and are around their long-run averages. They don't seem to be moving up sharply, but again it's a risk we need to keep monitoring.

In addition, pay growth has been disappointing yet again. It was 2.3% in the three months to February, 0.7 percentage points below our February forecast. And we are forecasting some of this weakness to persist in the near term.

Pay simply seems unable to break out of its range. Whole economy regular pay has not exceeded 3% since the crisis over eight years ago. To illustrate the size of this puzzle, as Andy noted, to get rid of the negative residuals in the wage equation, in a mechanical sense, would require U* to be under 4%. Now some of the weakness in pay is due to higher non-wage costs, as the Agents have said. But that to me is unlikely to explain all of the weakness. There could be more slack than we think. Perhaps we should think again about whether the slope of the Philips curve has changed. But I think we are also seeing a Brexit effect dampening pay growth.

These factors taken together seem to be offsetting a labour market that is tight if you measure it by pre-crisis standards. But I don't see any reason to think that picture would change anytime soon.

So putting all that together, the evidence to me suggests that the broad narrative of the February forecast of a slowing in growth over the course of the forecast driven principally by squeeze on real incomes remains a valid narrative. I could agree the changes we've made to the growth and inflation profiles for the May forecast though the data to me suggest the risks are now a bit more on the downside, particularly for growth in the near-term.

So I see no need to change my tolerance for above target inflation nor to change policy. And my provisional vote is for no change in policy.

Finally, while it does not form part of my decision this month I do think we should bear in mind that our forecast and our narrative assigned a zero probability to the chance of a messy Brexit outcome with an economically disruptive transition to the UK's post Brexit arrangements. This is probably the main reason, as Ben has said, for the difference between our forecast and the forecast that underlines the market curve. That possibility of a messy outcome is well within our forecast horizon. I don't believe we should try and factor it in. It's probably impossible to quantify accurately the risks or the impact, though I hope the work the staff are now doing will give us a better appreciation of the scale of any possible effect. We can react if we see this risk crystallising but it's something I think we should keep not that far towards the back of our minds.

Governor Carney. Okay. So, Kristin and then Michael, please.

Kristin Forbes. My views today can be summarised by an old adage – one more familiar than my "old adage" from Wednesday: "The more things change, the more they stay the same." Since our last MPC round, there have been noteworthy changes in a number of economic indicators. When all netted out, however, my stance on monetary policy is the same. My comments today will therefore only quickly summarise the main changes relevant to the monetary policy trade-off and not repeat my comments from last round. Instead, the second part of my comments will shift gears and summarise new research results which have influenced my thinking on monetary policy today.

To begin, what has changed on the slack side of the monetary policy trade-off? The preliminary estimate of Q1 GDP growth was 0.3% – weaker than Q4 and our expectation. This weakness primarily reflects the real income squeeze from higher inflation and corresponding slowdown in consumption growth. As discussed Wednesday, however, I think this 0.3% exaggerates the extent of the slowdown. Yes, growth is slowing, but recent indicators suggest that at least part of the Q1 weakness is erratic. The Q1 softness likely partially balances the unexpected strength in Q4, and the timing of Christmas and Easter. Revisions to Q1 data tend to be positive and significantly larger than in other quarters – reaching 0.2 percentage points on average (albeit not until two years after the initial release). Recent indicators – such as the trifecta of strong PMI data – supports other evidence growth picked up in April. The pyramid of high frequency indicators, with all its caveats, has about two thirds of its cells flashing above-average growth, and only one cell (retail sales) flashing growth well below average. Continued evidence of healthy global demand should also support UK growth.

The labour market data continues to show more strength than deterioration, from sharp upside surprises in hours worked, to the shift from part-time to full-time employment, to the steady decline in the unemployment rate to 4.7%, to increased recruitment difficulties in the Agents' data, to above-average hiring intentions in the surveys. The output gap is not deteriorating in a meaningful way, and if you believe there is currently little slack in the economy, there is likely to be little slack in the future if growth evolves as expected.

On the other side of the trade-off, there have also been changes in the inflation data – changes that reinforce my earlier concerns. CPI inflation was 2.3% in March, 0.3 percentage points above our February forecast. After adjusting for Easter, inflation in March would have been closer to 2.5 to 2.6%. This largely reflects pass-through from sterling's depreciation, with core goods inflation 0.5 percentage points higher in March than expected in February. It is impossible to tell if the news reflects faster or greater pass-through than expected. But many other indicators suggest substantial inflationary pressure remains in the pipeline. The STIF provides further warning, predicting October inflation of 2.9% – higher than any quarter in our forecast. Inflation could well be higher in the short-term, and elevated for longer, than we expect.

Weak wage growth and sterling's recent appreciation will partially dampen these upside risks to inflation. But will these dampening effects continue? Sterling could continue to be volatile and affect inflation forecasts, but in what direction I do not know. Wage growth could continue to disappoint due to Brexit uncertainty, but recent weakness is unlikely to continue in the face of higher inflation and labour market tightness. Moreover, stronger DGI suggests that more underlying price pressure is building than simply the temporary effects of sterling's depreciation. Half of the DGI measures I follow are currently at levels consistent with headline inflation around or above 2%. A few are weaker – namely unit labour costs and the GDP deflator – but those are the most volatile and have the lowest signal to noise ratio. The variance-adjusted average of the DGI measures has increased from 1.4% in Q3 2015 to 2.0% today. This will probably continue increasing over the next few months to surpass a level consistent with inflation at 2% sustainably.

Pulling this together, despite changes in a number of key indicators, I see the monetary policy trade-off as similar to last round. Inflation is already above target and heading higher to uncomfortable levels. It will likely remain above target for over three years if Bank Rate follows the yield curve. Yet this meaningful inflation overshoot coincides with only a small (if any) output gap. I see little "trade-off" from a moderate reduction in the monetary stimulus being provided today.

Shifting gears – let me summarize an entirely different approach to thinking about monetary policy, from a project I've been working on with and . This project attempts to explain inflation dynamics, but avoids the formal DSGE framework and corresponding assumptions about underlying structural relationships. Instead, we focus on the time-series dynamics of inflation and isolate a slow-moving component of inflation (what we call a "trend") from short-term deviations around this trend. Then we test what variables affect this persistent trend inflation and the short-term deviations around it. We estimate this trend using an unobserved-component stochastic volatility model with an autoregressive component adapted for the UK.

We find several noteworthy results. Different measures of UK inflation show a high degree of persistence. Our estimated slow-moving trend plays a powerful role in explaining inflation. Most interesting are the variables explaining UK inflation dynamics: across a range of tests, most important are global variables and the exchange rate. Commodities/world export prices are the only variables consistently significant in explaining the short-term movements in UK inflation around the persistent trend. The exchange rate is the only variable consistently significant in explaining more persistent movements in inflation. Other variables emphasised in standard models, such as slack and inflation expectations, play some role, but their significance fluctuates. And even in specifications when inflation expectations and slack are significant, the magnitude of their role in explaining inflation dynamics is much, much, much smaller than for commodity prices and sterling.

These results have implications for monetary policy today. Inflation dynamics are dominated by a slow-moving trend and this trend is only marginally affected by most of the variables central to modelling inflation and which we spend so much time trying to precisely estimate (i.e. slack). These models are still useful, but we should appreciate their limits.

There are also implications for when monetary policy should look-through deviations in inflation from target. If the deviations are largely driven by movements around underlying trend inflation, than there is no need to respond. For example, although commodity prices significantly affect UK inflation, since these generally don't affect the underlying trend, the effects should be short-lived and, in isolation, not merit a monetary policy response. This supports the approach we took to lower oil prices in 2014/2015.

In contrast, movements in sterling primarily drive movements in the trend underlying inflation. This suggests that monetary policy should usually not "look through" sterling's effects on inflation. Exchange rate movements will move inflation away from target for a prolonged period and the effects are likely to be persistent. If there is slack, this could partially counteract the impact of a depreciation on trend inflation. But the estimated magnitudes suggest you would need a large amount of slack to provide a meaningful counterbalance.

Moreover, the results suggest that there is more of a cost to delaying action than we generally believe. Our estimate of trend inflation increased sharply at the end of Q1 to 2.1%. It will continue to increase. The *Inflation Report* forecast for the output gap will not be anywhere near enough to counterbalance this upward movement in trend inflation from sterling's depreciation. This suggests inflation will remain higher for longer than we are forecasting, and will not come down unless there is a substantially sharper slowdown than we are currently expecting - or unless Bank Rate is increased. Most important for timing, the longer the trend is above 2%, the more this overshoot becomes ingrained in the trend and inflationary dynamics, making it harder to bring down.

Therefore, although there has been much “change” in the economic data (and my discussion topic this month), my vote will be the same as last round: an increase in Bank Rate and no change to our stock of assets. There is not enough evidence of weakness in the real economy to tolerate inflation overshooting target for such an extended period. Given the upward shift in the underlying trend rate of inflation, I believe we should act to ensure that the overshoot does not become even more protracted and harder to unwind.

Governor Carney. Michael and then Jan please.

Michael Saunders. Thank you. At the March meeting, I was close to voting for a rate hike. Compared to our base case, I expected a bigger inflation overshoot coupled with a greater reduction in slack. On that basis, I thought the current policy stance was overly accommodative, and my guess then was that I would be voting for a hike around now.

In practice, business surveys suggest that the economy continues to grow steadily, at a pace slightly above potential, with recoveries in exports and investment roughly balancing the consumer slowdown. Global growth is better, reinforcing prospects for continued UK growth. The economy might be further supported if, in line with the Credit Conditions Survey, but in contrast to the IR base case, credit spreads for mortgages and corporates narrow further over the forecast period.

Inflation has picked up markedly. As I noted at our discussion on Wednesday, the pace of price hikes was exceptionally strong in Q1. In seasonally adjusted quarter on quarter terms, the Q1 gains in the CPI and retail sales deflator were both among the sharpest of the last 20 years, and well above the pace consistent with the inflation target over time. This produced a sharp quarterly drop in real wage income, which probably contributed to the consumer slowdown. The rise in CPI inflation has been especially marked in items with an above-average import content. Surveys of costs and prices suggest a further significant rise in year-to-year inflation is likely in coming quarters. All this is consistent with the possibility that the ONS import price data understate the extent of import price gains, and/or that second-stage pass through will be greater or faster (or both) than our benchmark implies.

With current levels of commodity prices, I suspect that CPI inflation will slightly exceed our base case in the forecast period over the next couple of years, largely reflecting greater pass through. This, by itself, might produce some downside risks to household real incomes and consumer spending, but in terms of overall GDP growth is likely to be roughly offset by a slightly bigger joint impetus from net trade and investment.

Pay growth remains subdued, but labour market slack continues to shrink. The jobless rate is still gradually falling, while under employment has fallen quite sharply in recent months. The tightening in the labour market is evident also in the renewed rise in vacancies and the agents’ measure of recruitment difficulties. Surveys of firms’ hiring intentions suggest that labour demand continues to outstrip the modest growth in labour supply, implying that further gradual declines in both unemployment and under employment are likely. We have again lowered our unemployment forecast. I suspect that risks lie on the side of an even lower outturn, such that the jobless rate closes the remaining small gap with our U* estimate in the next few quarters, rather earlier than our base case.

I am already slightly uncomfortable with the prospective trade-off between inflation and slack implied by the *Inflation Report* base case. I am even more uncomfortable with the prospective trade-off if, as I suspect is likely, we get a somewhat more extended inflation overshoot and faster elimination of slack than our base case.

If I could stop there, I would probably vote for a hike at this meeting, in order to produce a less unfavourable prospective trade-off between inflation overshoot and slack.

However, there has been a significant downside surprise in retail sales volumes in Q1 and, as a result, in GDP. There has also been a modest, but notable, undershoot in housing activity.

For me, the key issue is how much to read into these data. It is possible that the retail sales and housing data are the leading edge of a sharp consumer slowdown that will ripple out elsewhere. But it is also possible that the Q1 weakness is partly erratic or idiosyncratic and overstates the prospective consumer slowdown in coming quarters.

For example, the first quarter retail sales data may have been depressed by erratic weakness in sales by small retailers, the very strong pace of price hikes and resultant sharp quarter on quarter drop in real wages, plus difficulties in getting correct seasonal adjustments around the variable date of Easter. As the staff note, we do not see the typical signs of a sharp consumer slowdown. Consumer confidence and major purchase intentions are both slightly above their long-run averages. This is not to deny that consumer spending is slowing, but even with upside risks to our inflation forecasts, it may not slow more than our base case.

And the housing slowdown may largely reflect the decline in buy to let activity, following last year's rise in Stamp Duty and this year's start of the withdrawal of mortgage tax relief, and hence may not tell us much either way about broader trends in consumer confidence. In the first two months of this year – as far as we have full data – the total number of mortgage loans fell 5% year to year but this included a 40% year to year drop in Buy to Let loans. The number of first-time buyer loans rose 10% year to year, and that is actually a faster year to year growth than the second half of 2016. Our Credit Conditions Survey reported a very sharp drop in demand for Buy to Let mortgages in Q1. In contrast to the softer tone in overall mortgage approvals, which include Buy to Let, GfK report that the net balance of people who believe it is a good time to buy a house is now the highest since this quarterly survey began in 1990.

I lean more to the view that the Q1 weakness in retail sales and housing exaggerates the prospective weakness in consumer spending. I put more weight on the message from business surveys that overall economic growth remains solid.

So my expectation is that we will probably see slightly higher inflation and/or a faster reduction in slack than our base case. If that does happen, I will probably be ready quite soon to vote for a less stimulative stance. A 25 basis points rate hike would still leave a fairly loose policy stance, indeed one that is somewhat looser than a year ago, despite higher inflation and reduced slack over that period.

There are potential costs from waiting, in that inflation expectations might rise significantly. I am slightly worried by the marked rise in surveys of firms' pricing intentions, especially the BCC and CIPS surveys for the service sector, which hint that inflation expectations already may not be as well anchored as we generally believe. But so far, most guides suggest that our low inflation credibility is intact. Hence, on balance, I am inclined to vote for no change in this month, and to wait – perhaps for a fairly short period – to see more data.

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

Gertjan Vlieghe. Going into this forecast round, I thought GDP growth this year should be slightly lower than in February, largely due to a revised consumption outlook of growth closer to 1% than to our previous forecast of nearly 2%. I also thought the forecast should be somewhat u-shaped, which is an implicit point about r*. These two features are now part of our May forecast. I think the upward revision to investment and the global economy are justified in direction, but a little on the high side in magnitude.

My comments today will largely focus on consumption and r*.

In the March meeting I outlined why I put more weight on the sharp weakening in retail sales than a simple correlation with consumption would suggest. I also pointed out that car sales, housing and confidence data were holding up better, which was somewhat of a puzzle. The pieces of the puzzle are now starting to fall into place.

Yesterday's data on car registrations showed a very sharp weakening, supporting the story highlighted by the Agents that the strength of car registrations in recent months was due to a bringing forward of sales ahead of the April tax increase. It now looks like car registrations had in fact been on a slowing trajectory, masked temporarily by the tax-anticipating boost.

Housing data have also been noticeably weaker in recent months. The RICS new buyer enquiries balance has fallen steadily from its local peak in November, housing transactions have stopped rising, and approvals have fallen for the past two months. The Nationwide house price index has also fallen for two consecutive months, and the Halifax index has stagnated.

There remains the fact that consumer confidence is still at levels consistent with robust consumption growth. I have no explanation for that, but I do note that consumer confidence has rather let us down in the past five years as an indicator of consumption growth. As I said in March, consumer confidence appears to be useful mostly as an indicator of drastic changes in consumption growth, not episodes of mid-cycle acceleration or slowing.

My overall take on the consumption-related indicators is that the consumption slowdown that we had been expecting, but whose timing had confounded us, has begun around the turn of the year.

While it is true that Q1 is the quarter of peak real wage contraction in our forecast, as Michael has pointed out, real wages are expected to be broadly stagnant, and below consumption growth, until early 2018. I see no reason to expect the consumption slowdown to be short-lived. First, since consumers only started responding to weaker income growth with a two-quarter lag, why would they respond to stronger – meaning less negative – income growth immediately? Second, the fact that the weakness initially seen in retail sales is now spreading to cars and housing suggests a broader slowdown is underway, rather than simply a rise in prices leading to a mechanical reduction in volumes.

Because I think the consumption slowdown is driven by real income dynamics, which in turn are the largely driven by hump-shaped exchange rate pass-through, I do expect consumption to be picking up again in the second half of our forecast. Conditional on the continuation of the improved global outlook, and conditional on a smooth Brexit, i.e. one with a pre-announced and pre-committed lengthy implementation period, investment growth should be improving too.

That brings us to my second point, which is trend r*. I find it impossible to think about the medium-term outlook without thinking about trend r*. I also find it impossible to think about the extent to which the market yield curve is consistent with my forecast and my interpretation of the remit without thinking about trend r*.

Taking together a broad range of mechanisms that are likely to have depressed trend r*, I think a reasonable mid-point estimate is around zero in real terms, i.e. 2% in nominal terms, give or take a percentage point on either side. These mechanisms include a growing cohort of ageing workers and retirees wanting to hold large stocks of safe assets for an increasing period of retirement, a fall in the growth rate of the working-age population requiring lower investment growth in real capital, expectations or fears of a lengthy period of weak growth, and income skewed towards those with a lower marginal propensity to spend. These mechanisms are not additive, and interact in complicated ways. Ageing can simultaneously raise the supply of savings, lower the marginal propensity to spend, lower productivity growth and reduce risk tolerance.

Given that in my central forecast the UK economy is likely to be close to a full employment state in the next three to five years, I would expect that our real policy rate will need to reach trend r* over that horizon.

The UK yield curve has forward rates of 0.62% in three years, around 1% in five years, and 1.5% in 10 years, based on the SONIA curve. To be clear, that is not the market's view of the most likely path of rates. Forward rates are risk-weighted and risk-adjusted expectations. Risk-weighed, in the sense that these are rates averaged across a wide range of scenarios, presumably including some with low growth and low inflation where policy rates do not rise at all. Risk-adjusted, in the sense that there are risk premia of uncertain size and sign included in these yields.

As a policymaker I would never say that market yields at these horizons are "wrong". I have no informational advantage over financial market participants about the medium to long-term probabilities of various economic scenarios, nor about what the right level of risk premia should be.

But what I can say, is that if I were to draw the path of policy rates that is consistent with my central forecast and with my interpretation of our remit, that path would be higher than these forward rates. The simplest way to communicate that would be to show our own, forecast- and remit-consistent, projected path of policy rates.

I sense that I am in a minority in wanting such a communication strategy at this stage, and I understand the communication challenges associated with it. A second-best option is to show a forecast conditional on the market yield curve that is not quite consistent with our remit, i.e. has inflation higher than my own trade-off parameters would suggest is appropriate.

Note that this second-best strategy also has communication challenges. An interest rate forecast speaks for itself. A market-rate based forecast that shows inflation above the target does not speak for itself, it needs further clarification. There are three reasons why the inflation forecast might be above the target. The first case, let's call it the "trade-off forecast", is one where we deliberately allow inflation to be above target for a period, because the projected output gap justifies the trade-off. The second case, let's call it the "different curve forecast" is that we show a forecast of inflation above the target because we think the market curve is below our central forecast for our own rate path, so we do not expect the above-target inflation to materialise. The third case, let's call it the "tabloid forecast", is simply that we have gone soft on inflation.

Until recently, we were largely in the "trade-off forecast" zone. We are now switching to the "different curve forecast", or at least a blend of the two. It is important to make this transition clear, because the forecast by itself does not allow outside observers to distinguish between the two.

Even once we have clarified that we are now moving towards a "different curve forecast", scope for misunderstanding remains. It could imply that a rate hike is imminent, or it could imply that a rate hike is not imminent at all, but, later in the forecast period, our central expectation is that we will be putting rates up faster than market forward rates. Given that we are currently facing slowing growth, still subdued underlying inflation pressures, and for the asymmetry and risk management reasons I have discussed before, I am definitely in the latter camp.

Governor Carney. Thank you, Jan. Andy, please.

Andrew Haldane. Thank you, Governor. There are merits in incrementalism when it comes to changing interest rates. But there are perils in incrementalism when it comes to judging the appropriate level of interest rates. So as I reach the three-year mark of my MPC tenure, I thought it was a good time to zero-base-budget my view on the appropriate monetary stance. And the case for doing so has strengthened anyway over the past six months, with the signs of greater momentum in the UK and world economies, momentum that has not in my view been fully reflected in the sterling yield curve.

So as a way of challenging my dovish predisposition, I began by assembling the best arguments I could muster for a rate rise, now or in the near future. First, the world outlook is materially brighter than it has been for some time, perhaps at any time since the global financial crisis. This year's Spring meetings saw the first upgrade of IMF world growth forecasts for seven years. And our world growth forecasts are about to follow suit. That recovery appears, moreover, to have a broad base across regions. That ought to give it greater momentum and durability, given the importance these days of cross-border financial spillovers and global supply chains. Indeed, we may be seeing the first signs of that in recent data on global trade, capital goods orders and industrial production, all of which are picking up.

Greater optimism about future world demand would be expected to encourage businesses to start putting their balance sheets to work, expanding existing capacity and investing in new. If so, I could imagine that momentum continuing to build, across firms and over time, as firms' animal spirits spread and as global supply chains re-open. That could herald the beginning of the end of the protracted post-crisis super-cycle of weak investment and productivity.

Second, the gap between political and policy uncertainty, on the one hand, and economic and financial uncertainty on the other seems to me to have shrunk materially over the course of this year. It has done so because political uncertainty has fallen materially. Media measures of course say the opposite. But these measure political news, of which there has been plenty recently, rather than political uncertainty.

On the latter, this year has seen the worst fears about President Trump's economic and trade policies failing to materialise. It has seen the feared populist surge through Europe failing to crystallise, first in the Netherlands, most recently in the first round of the French elections, and most probably in the forthcoming German ones.

Here in the UK, the announcement of a general election has reduced, rather than increased, political uncertainty, not least if it increases the chances of a smoother, if not softer, Brexit. This fall in political risk seems likely to have contributed to the rise in global asset prices and the fall in global risk premia. And for some firms, it may have removed another obstacle to them putting their balance sheet to work.

Third, as the world economy has gathered pace, downside risks to global inflation have eased. Since August, five-year five-year inflation swaps have risen by around 40 basis points in the UK and US and over 30 basis points in the euro-area. The shift in inflation narratives has been more striking still.

Google searches for the word "deflation" have nudged down this year, having been elevated for the previous three. Searches for the word "reflation" have done the opposite, rising three or fourfold comparing this year with last. This shift in inflation expectations has reduced the degree of risk asymmetry around the ZLB. The need for monetary policy "insurance", on risk management grounds, is thus somewhat lower than nine months ago. More speculatively, higher inflation might also encourage firms to bring forward their spending on capital goods if they are expected to be more expensive tomorrow.

Fourth, closer to home, some of the worst of the post-referendum fears about UK growth have also failed to materialise. Our forecasts for UK growth this year have been revised up by over a percentage point since August. And smoothing out the bumps, surveys of consumer and business confidence have scarcely budged over that period, pointing to robust, around-trend, growth.

With their balance sheets strong, their cost of capital low and with demand for their products, both domestic and external, buoyant, this might be the time for UK companies to emerge from under the duvet. We may be seeing some signs of that in recent investment intentions surveys.

Fifth, despite all of the above, the sterling yield curve has been strikingly unresponsive, both to data news and to MPC communications, as Ben pointed out. In my view, that yield curve remains at levels that are difficult to justify, given the balance of risks facing the UK economy. UK real rates are at no point expected to be positive over the next 50 years.

Perhaps the lesson from US experience, where interest rates have been much more responsive both to data news and to FOMC communications, is that it is only policy actions that cause the curve to pay attention.

Sixth and finally, any tightening in policy needs to be placed in context. A 25 basis point rise would do no more than remove a proportion – according to our GDP ready-reckoners, around a quarter – of the incremental stimulus we provided last August.

On those six pillars rest the case for tightening policy soonish. And for what it is worth, having erected these pillars, they seem to me reasonably robust ones, albeit inevitably vulnerable to Brexit earthquake risk.

So what of the other side of the argument? Well for me, the most compelling counter-argument is the continuing lack of much evidence of any significant build in domestic inflationary pressures. Nowhere is this more evident than in the labour market where wage growth is, if anything, in retreat. It is at similar levels today to those which were prevailing when unemployment was at its peak of 8.5% in 2011. Measures of domestically-generated inflation show some greater signs of life. But, my, this nominal build has been very slow. And DGI measures on a principal component basis remain 0.7 percentage points below the level consistent with the inflation target. If DGI rose at similar rates to the past few years, during which slack was being eroded sharply, it would take another three years or so before they reached target-consistent levels. And past rates of slack erosion are of course very unlikely to be replicated over the next three years.

Second, there is still a non-trivial risk of the UK economy reacting more discontinuously to Brexit risk, perhaps because consumers or companies take fright and start building precautionary savings rather than running them down. This tail risk, of a "Brexit break" in the economy, cannot be dismissed with consumption plainly slowing, perhaps rapidly, and it seems to be a key factor holding down the yield curve at present.

But while this risk is real, there has been nothing in the data recently that has, in my view, increased this risk significantly. Certainly, the Q1 GDP numbers did not leave me thinking that either consumers or companies have begun slamming on the brakes.

Third, given the yield curve, any rise in interest rates soon would come as a significant surprise to financial markets, consumers and businesses. As people tend not to like nasty surprises, this increases the chances of a tightening causing an oversized response in spending or asset prices, perhaps even one which catalysed that "Brexit break".

So where does this leave the balance of arguments? Well my zero-based budget has not led me to wish either to tighten my monetary policy belt, nor to loosen it, immediately. I do think, though, that the balance of risks between tightening "too early" and "too late" has swung towards the latter in the past six months. And "too late" would not be good for incrementalism when it comes to in interest rate changes in the future.

Will next week's Inflation Report help rebalance these risks? Well our published inflation and output trade-off clearly suggests a tighter stance, relative to the yield curve, than in any recent *Inflation Report*. Equally, past evidence should not lead us not to expect too much from our words and pictures.

For today, I am minded to vote to maintain interest rates and the stock of asset purchases at current levels. But my judgement is now balanced towards thinking a partial withdrawal of the additional policy insurance we put in place last year – actions rather than words – may be prudent in the relatively near future, and certainly well ahead of current market expectations provided the economy evolves broadly in line with our forecast. Thank you.

Governor Carney. Great, thank you Andy. Ok, I will go through my comments and then try to sum up. So looking back to the three key judgements that underpinned our February outlook, the news has been to the downside, and to the downside rather than broadly on track, as we said in our March MPS. Wages notably softer, household spending slowing sooner, and perhaps more sharply than expected, and while sterling pass-through has been in line on net, it will likely be lower over the forecast horizon, assuming the appreciation since February persists. I will elaborate briefly on those as others have.

On wages, whole economy total pay growth looks likely to be 60 basis points weaker than expected in Q1, and almost a point weaker at Q2 and half of that news accounted for by regular pay. There's little to suggest that unit labour costs not will be similarly soft.

The hard data on household spending, as others have observed, has been much weaker than expected. Retail sales fell by 1.4% in the three months to March, the largest quarterly fall since 2010, and total consumption seems likely to underlie the greater-than-expected slowing in GDP growth to 0.4% on the back-cast in Q1. Indeed, a bottom up projection for consumption growth, based on output data, would point to consumption falling in Q1. Not what I expect, but just to give a sense of magnitude.

Auto sales in April were alarmingly, and one assumes somewhat erratically but not totally erratically, weak.

And some of the broader indicators of household spending growth have also softened. Housing market activity and inflation both came in below expectations. The RICS survey corroborates the picture of near term weakness.

Annual growth in consumer credit has continued to decelerate from its recent elevated rates, although, as Michael observed the other day, monthly flows have remained fairly stable.

The main exception to this softening picture is consumer confidence, which has remained stable in April, just above its long-run average.

Near-term conditions also look less supportive of consumption growth than three months ago. Credit conditions are likely tighter, given the announced review of underwriting standards by the PRC and the likely re-imposition of the Counter Cyclical Capital Buffer by the FPC in July. If you know how to read FPC reports that's all but certain. The results from the Credit Conditions Survey, collected before the PRA review was announced, already point in that direction, although certainly the magnitude is hard to judge and it seems outsized relative to likely moves. Adding to that, downward revisions to wage growth mean the squeeze in real incomes is likely greater than previously anticipated.

On sterling pass-through, netting the two stages, our judgement looks broadly on track, with the 2.5% appreciation relative to the conditioning assumption in February implying a drag further out, as I said.

Now, as we flagged in March, and as we've been discussing, there's possible offsets to the inflation outlook to this weakening in household spending and the still relatively somnambulant DGI, at least to my read. And those include a stronger world outlook; a recovery in investment and net exports; likely higher short-term inflation; and our judgement – based on labour market quantities – that the output gap hasn't in fact widened, despite weaker growth. And all of those are in our forecast now.

Just a bit more detail on that.

Investment intentions, including our latest Decision Maker Panel, a panel which is broadening and deepening, point to a pickup in business investment growth in the first half of this year, with balances increasing across almost all surveys in recent releases. On the back of that, business investment in the May IR is now projected to be 3 percentage points higher in level terms at the end of the forecast than in February.

Surveys of export growth have also been rising, particularly the manufacturing sector balances.

And PMIs suggest that global momentum has increased since the start of the year. We've taken a strong signal from them going forward. We're at the top of consensus, and the May IR projection for UK-weighted global demand ends the forecast half a point higher than in February, mostly accounted for by the euro area.

The likely higher short-term inflation outlook in part reflects a locking in of upside news in March, which came from a range of other goods prices. And we've added 10 basis points of news from household energy bills.

The more buoyant outlooks for investment and trade reflects some support coming from lower uncertainty. As others have observed our standard measure has come in a little lower than anticipated, and it's tempting to hope that the election will increase the prospects for a smoother Brexit.

To be clear, our forecast assumes a smooth Brexit will happen, and its prospect will reduce uncertainty and reinforce the more positive outlooks for investment and trade.

So turning towards policy, I will, I will quote an adage seldom used, but useful. Time consistency is an advantage when you're trying to reveal your reaction function. On balance …

Kristin Forbes. That's as well known as mine!

Mark Carney. Yeah, let's see, we can …

Ben Broadbent. As my grandmother used to say!

Mark Carney. I repeat, time consistency is an advantage when you are trying to reveal your reaction function.

On balance, the projection paints a more modest trade off, closer to the origin, over the policy horizon, i.e. out to two years, even with a path of market rates as flat as at present – and it's a trade-off that's clearly inside, inside, our revealed tolerances in February and November and arguably, August as well. The story is different—somewhat by construction—in year three, when the gap is closed and inflation is above target, albeit due to a combination of residual pass through and higher assumed utility prices.

If this more robust forecast comes to pass, I'd favour taking back some of the stimulus we provided post referendum, above and beyond what's implied by the market path.

But I'd also favour a tighter path if I grew more confident about the prospects for a smoother Brexit, or if the global economy gained further traction supporting r*, thereby increasing the amount of stimulus implied by unchanged policy.

But what does that imply for policy today?

For now, the story I described is just that, a story based on surveys and hope. Thus far, the reconciliation between consumption and financial asset prices that we talked about in March, it's now underway and it's not a bullish one.

Before acting, I'd like to see firmer nominal developments here, softer consumption being cushioned by a more active (not just a more confident) corporate sector, and confirmed strengthening abroad. I won't hold my breath over the possibility of a smoother Brexit just yet.

Moreover, if, as I believe, we will need to withdraw more stimulus than implied by the market curve, and I think that's a belief shared by several others, I would be minded to act at a more, at a time more consistent with the policy horizon. That is, later in this year as implied by the February curve. It isn't necessary to act today to address a forecast overshoot in three years. And would seem a bit heroic to do so at a time when consumption's decelerating and we're in the midst of an unholy row with our European partners.

So even though I think that the integral of policy tightening implied by the market interest rates and sterling is too modest, I'm not obsessed with shifting the curve next week.

As I said the other day, I'm more "hawk minus control". I'm bothered that the curve has flattened relative to February, again, a curve which incorporated a tightening later this year, but I wouldn't have gone so far as to try steepen the February curve.

I would want to lay the ground work for the curve itself to firm up in coming quarters if the economy performs in fact, rather than in merely prospect. And I think we can set the stage for that through some combination of our forecast, the re-iteration of our framework and noting that monetary policy may need to be tightened sooner and to a greater extent than implied by the market path if the economy evolves largely in line with the forecast.

And I'll stop there. I will note that that formulation at the end is tougher than the formulation we used in March and I mean obviously we'll discuss it. We said that if upside risks happen we would act, we would withdraw stimulus. So we will have to think about how to pull things together, in both the MPS and the minutes. My calculation, I didn't quite know, you didn't, you reserved the right.

> **Ian McCafferty.** I reserved the right to wait till next Wednesday,

Mark Carney. Ok

Mark Carney. It's not to summarise the, summarise the thing, the probable no change, probabilistic, yeah, probabilistic outcome. I think we will just, we'll just have to think about this. I don't want to have too many salami slices of, you know, I'm a little, I'm hot, I'm a little bit hot, I'm hotter, I'm mid-range, so we'll have to try and nest this in a way that works.

> **Ben Broadbent.** I mean, to be clear, we, and what I view was, you know, three different buckets in March and we could do something similar. We'll think about it, it's not an insuperable challenge.

Mark Carney. No.

> **Ben Broadbent.** In the minutes.

Mark Carney. Okay, alright, so why don't we, why don't we close the meeting now and then we'll do our necessary stuff with the forecast.

A meeting of the Monetary Policy Committee was held on Wednesday 10 May 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
Sarah John, MPC Secretariat
Simon Hayes, MPC Secretariat
Melissa Davey, Editor of Inflation Report

Transcript of the Monetary Policy Committee Meeting on

Wednesday 10 May 2017

Governor Carney. Ok, good afternoon, so we're here for the Decision Meeting. We'll start with an update on financial markets and then two quick data points.

> **Ben Broadbent.** Yep. Thank you, Governor. Financial markets, there's quite a bit because they've moved materially since we closed the forecast and, and relative to the conditioning of paths we had as well. So, I mentioned oil at the end of last week, it's actually up fractionally since the close last Friday, but it's still 10% lower in sterling in terms we'd assumed in the IR. The implications of that for inflation will be to push it through mainly in the first year and indeed by the end of the forecast, because it also pushes up on growth it's assumed to be supply led for implicitly if anything goes in the opposite direction. But at the same time we've had material rises in both sterling, up a further percent relative to May, and also, in particular, in interest rates. So the three-year OIS rate, for example, is over 15 basis points higher than the path for May. It's pretty much back to what we had in February. So if you compare February to May we've got basically the same path of interest rates but an exchange rate which is 4% higher. And it is quite important, to bear in mind at least, for communicating the forecast, I'll make one material point in that respect, we made quite a big deal of the fact that by the third year of the forecast conditional on the yield curve we had, there is no output gap and inflation is above target by a quarter point. If nothing else changed and we pushed through these increases in interest rates and the exchange rate, we'd now have an output gap of, not big, but 15 basis points, and would have an inflation overshoot of 15 basis points. So we still have a 1:1 trade off in the forecast as far out as the third year on these new asset prices and in some ways that's the kind of path we saw in the optimal policy simulations, which is the moves required to get to some sort of, for a range of lambdas weren't that different to begin with and what we had clearly the yield curve was lower than the, optimal policy given the other conditioning assumptions, but not that much lower. So it is what it is, we have this and we take those things as given and nothing seems to happen at the moment they move a lot, nevertheless it's worth bearing in mind as we move into the phase of communicating this. So this, because the danger is that everyone reacts to the yield curve as it is right then, rather than failing to take into account and move we've had since closing the forecast.

Governor Carney. Ok.

> **Ben Broadbent.** And by the way the VIX fell further.

Governor Carney. The RICS, alright, good. Okay, in terms of IoP data which will come out tomorrow morning, so before our statement, we have for March, industrial production fell by ½% compared to February. Staff had expected a 0.7% decrease; market forecast was a 0.4% decrease. The fall was driven by 4.2% fall in utility output reflecting unusually warm weather. When did we have unusually warm weather?

> **Ben Broadbent.** Unusually being the key word.

Governor Carney. Yeah I was going to say. I haven't put my parka away yet. March was warmer, yeah, March was warmer than May, that's for sure. Manufacturing and energy production both declined, by 0.6 and 0.7% respectively. Three months to March, industrial production increased by 0.1%, weaker than the 0.3% estimated by staff, driven by a larger than expected fall in the energy sector and weaker than expected growth in manufacturing. Which came out as 0.3% actual versus 0.5% estimate. So that is that. Okay? Andy, do you want to do a quick?

> **Andrew Haldane.** Very briefly though my news isn't very new, actually. But we did have, since we last met, non-farm payrolls in the US last Friday, 211,000 which was slightly stronger than expected. There were back revisions in the overall Q1 position isn't very different than what we expected. And then we had the BRC retail sales monitor for April, that was a sharp rise, though a big Easter effect

in there and the overall pattern, I think, is of that indicator now showing a similar, a more similar pattern than retail sales which had been tracking below prior to that. That's all, thank you.

Governor Carney. BRC has come back up to retail sales …

Andrew Haldane. It has.

Governor Carney. Okay. Any other? Alright, so let's turn to the decision, so I'm proposing three propositions. First, that Bank Rate be maintained at 25 basis points. Secondly, that the Bank of England maintain the stock of sterling non-financial investment grade corporate bonds, financed by the issuance of Central Bank reserves at 10 billion sterling; and thirdly, that the Bank of England maintain the stock of UK government bond purchases, financed by the issuance of Central Bank reserves at £435 billion. Okay. So I'll try to go in the same order as we discussed on, last Friday, start with Ben.

Ben Broadbent. I vote for all three propositions.

Governor Carney. Okay, Ian?

Ian McCafferty. In favour of all three propositions.

Governor Carney. Jon?

Jon Cunliffe. In favour of all three propositions.

Governor Carney. Kristin?

Kristin Forbes. For an increase in Bank Rate by 25 basis points and holding both stocks of assets constant.

Governor Carney. Michael?

Michael Saunders. I vote for all three propositions.

Governor Carney. Jan?

Gertjan Vlieghe. In favour of all three propositions.

Governor Carney. Okay, Andy?

Andrew Haldane. I vote for all three propositions.

Governor Carney. Okay and I will vote for all three propositions. So, by my count, that is 8 votes to nil, 8 votes in favour of maintaining the corporate bond purchases and maintaining the stock, I should say stock of corporate bond purchases and 8 votes to nil, maintaining the stock of government bond purchases and 7 votes to 1 in favour of maintaining Bank Rate at 25 basis points. Let's do a count, that's good. And I think with that we'll close the meeting and unless there's anything else and then we will go downstairs on a beautiful, unusually warm …