BANK OF ENGLAND

MEETINGS OF THE MONETARY POLICY COMMITTEE
September 2017

A meeting of the Monetary Policy Committee was held on Friday 8 September 2017. The following members of the Committee were present:

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

Richard Hughes was present as the Treasury representative

The following members of staff were present:

James Bell, Director, Monetary Analysis
Alan Castle, MPC Secretariat
Sarah John, MPC Secretariat
Chris Young, MPC Secretariat
Melissa Davey, Editor of *Inflation Report*

Transcript of the Monetary Policy Committee Meeting on Friday 8 September 2017

Governor Carney. Good morning everybody. So we're just confirming that we will get the IoP data after this meeting, no advanced release of that. But we do have, courtesy of the ONS, the advanced release, advanced estimate I should say, of CPI for August, and it's only of CPI we don't have CPIX, it's 2.9%, versus a staff expectation of 2.8% and the market median is 2.7%.

And so we don't have all the details in terms of the upside surprises, except for a few things. The core of the upside is from clothing and footwear, where average prices have risen 2.4% between July and August 2017, compared to 1% on the same two months a year earlier. In fact, somewhat confusingly, they give a different figure for it which I won't quote, but effectively the rate of increase of clothing and footwear is the highest on record for the official CPI since the series started in 1996 and there is some speculation about sales timings and other things but once we get the full release people can pore through it.

So clothing and footwear, smaller upward effect from a range of recreation and cultural goods and services where prices rose slightly by 0.1% on the month compared to a fall of 0.3% in July-August of last year. And finally an increase on transport with an upward effect from motor fuels again compared with this time last year. Petrol prices rising by 1.8 pence per litre this year, compared with a fall of 1.8 pence a year ago. And finally on air fares, which is an obvious question to ask, the rise was just under 11% between July and August, which is smaller than the 14.4% recorded over those two months a year ago.

So headline CPI 2.9%, staff expectation 2.8%, market median 2.7%, and this is going to come out Tuesday, I believe. So that is CPI.

On labour force survey, headlines are that the quantities are line with expectations, some downside news on pay. So three months to July, the employment rate rose to 60.9%, which is consistent with an increase in employment of 181,000 heads, very slightly weaker than staff expectations of 61.0% and 212,000 heads. The unemployment rate over the period, 4.3%, in line with staff expectations, obviously down from 4.4% in the three months to June. Economic inactivity 30.6, sorry 36.3%, associated with a fall in 25,000 in heads, slightly stronger than staff expectation. And average hours worked, 32.2 per week in line with expectation.

So on pay growth, AWE total pay, so including bonuses, 2.1% in the three months to July, staff had expected an increase of 2.3% but obviously there is, you know given the higher bonuses it's a tough call to make on timing. Whole economy regular pay growth, so excluding bonuses, was also 2.1%, so 0.1% weaker than expected. I had a quick look at the fatter release, we'll get it in the fullness of time, but for those of you who are fans of three month on three month annualised, the three month annualised AWE ex-bonuses, which I thought was the right figure, so I just did it just before I came up, in June was actually revised down from 3½% to 3.2%. I don't know how often that happens actually for this …

> **Ben Broadbent** Not often actually.

Governor Carney. I would have thought so, it's weird, take that with a grain of salt, and people can delve into it. And then for July, same figure AWE three month-three month regular pay annualised is 2.9%, so … 2.9%, so both still up from where it was before but you may want to just adjust speaking notes if your central point is the 4% increase.

Ok, so that is advanced release again, so we are in a very privileged position now in getting that, no worries about that, but just, we'll recognise that, and Andy I'll turn to you to do a quick update.

> **Andrew Haldane.** No privileges on the IoP data, or indeed at 9.30 we also have construction and net trade data coming out too. Internationally, I would just mention briefly that we had the second estimate of Q2 GDP growth for the euro area, which was unchanged at 0.6, and globally the PMIs for August were up and are now at their highest level for three years. I think that will do, thank you.

Governor Carney. Ok, good. So if there's nothing else we'll turn to the indicative policy decisions and I will start with Ben and then go to Jan please.

> **Ben Broadbent.** Thank you Governor.

I'm obliged first to cover the news on the world economy since our last meeting. That was only a month ago and there hasn't been much. In Europe, the PMIs dipped very slightly in August but remained at elevated levels, consistent still with comfortably above-trend growth in GDP. That growth looks pretty widespread. It certainly includes the euro zone's largest country; within the German Ifo, for example, the components for manufacturing, construction and services all hit new multi-decade highs. But the surveys are also strong in France, Italy and Spain. This is unlikely to move our own near-term forecasts for the euro-area which have been above the consensus figure for some time. But it probably has contributed to the strength of the euro and, in part, the renewed weakness of our own currency.

There were also strong second-quarter GDP releases in the world's two largest economies. Growth was revised up to 0.8% in the US and hit 1% in Japan. The dollar has nonetheless continued to weaken, as expectations of fiscal easing fade and in response both to local political turmoil and events on the Korean peninsula. The dollar's slide might also reflect continued undershoots in inflation of wages and core consumer prices, and the associated softening of near-term expectations for US monetary policy.

The upward revision to US growth may not have done much for the dollar. But one thing it does mean is that the slowdown in our own growth rate, relative to other G7 economies, looks all the starker. In the year to the second quarter of 2016, per capita GDP growth in the UK was the same as it was in the rest of the G7, at 1.1%. In the year since, per-capita growth in the rest of the G7 has risen to 2%. Here it's fallen to 0.9%. And while growth in the rest of the developed world strengthened through the last year, we've seen the opposite trend here. All but a tenth of a percentage point of that 0.9% came in the second half of 2016.

Now, as we know, that deceleration in output has not resulted in much of a weakening in employment growth, whether over the year as a whole or during the course of it. Indeed the number of jobs has risen by more in the first half of this year than in the second half of last. Furthermore, a disproportionate share of that growth appears to have been in relatively low-skilled and low-paid jobs. And this could help to explain subdued growth in average wages. It suggests that the median wage may have risen somewhat faster. Were the composition of employment growth to stabilise, AWE would probably accelerate. It may already be doing so, on these higher-frequency comparisons.

We have spent some months warning that, following sterling's steep fall, and the inflation it produces, the yield curve is probably too shallow to be consistent with our objectives, given the other conditioning assumptions we've made about the future. Bank Rate would have to rise a little earlier, or at least by a little more, over the forecast horizon than markets had been expecting. The recent economic news, that in the labour market in particular, hasn't done anything I think to alter the view. With the exchange rate down again, and our medium-term inflation forecast likely to be that much further from the target, our collective tolerance may now be breached. That was clear I think from yesterday's discussion, which I found very useful.

Yet I'm not convinced that the rate rise needs to come right now – I anticipate voting for unchanged policy next week – I would want any guidance for November to be conditional on what remaining data there are. And, even when that time comes, I don't anticipate being 100% convinced of the need for it, sufficiently maybe, but 100% probably not.

There are some more standard cyclical points that affect my view. Ian has suggested that the strength of employment growth in the first half of this year was a delayed response to the strength of output growth in the second half of 2016. If so, then one might expect employment growth to slow from here. Consistent with that if fading compositional effects are responsible for the signs of faster wage growth we are seeing, such as they are, one imagines they should do the same to productivity. I'm not convinced that one month of small improvements in housing market activity necessarily means we've passed the trough, particularly when consumer confidence has continued to edge down.

And then there is Brexit. I continue to believe that the conditioning assumptions about the Brexit process in our forecast – and those of UK businesses and households – are significantly at odds with what's priced into financial markets. The referendum result has clearly had some impact on demand. With the world as strong as it is, and tradable-sector profits as high as they are, you'd have expected a big acceleration in business investment, not the stagnation we've actually seen.

But I cannot believe that investment discounts the same eventual outcome for Brexit, or the risks of a disruptive exit, that have so depressed the currency. The real exchange rate has fallen to a similar extent as in 2008 and 2009; the drop is otherwise larger than anything over a similar period of time during the last fifty years. The weakness of business investment, such as it is, is entirely unexceptional. Even in a mild downswing, like that of the mid-70s or early 2000s, it has fallen 4 or 5%. In a deep recession, such as in the early 80s or early 90s, it falls 9 or 10%. In the financial crisis it dropped by almost 20%. In the past year there's been no decline at all. So the statistical difference is very clear. And, as for consumption, there's been no rise whatever in the saving rate.

This discrepancy is inflationary. It's the source of the overshoot in our forecasts. If there were no Brexit risk and we'd had the same data on demand – if the slight softening growth were purely cyclical – sterling's fall would have been much smaller and our inflation projection would probably have been below the target.

Symmetrically, any reconciliation of those expectations is likely to be disinflationary. Either demand weakens or the currency rebounds, with knock-on effects for the appropriate level of Bank rate.

Now I can see two exceptions. One involves the nature of the deal, and we touched on this yesterday. If it's bad but smooth – if it ultimately hurts the UK but, thanks to an agreed transition, the hurt is long enough delayed not to bother domestic demand much – the currency would retain much of its weakness but domestic demand wouldn't weaken until much later. That's reconciliation delayed and the economy might behave in a similar fashion to what we've seen in the past year – weak sterling, sluggish but reasonable growth.

The other involves one's preferences and the invocation of exceptional circumstances. You might, until now, have thought that what should matter more for policy, I'm not saying this is necessarily what I think but I think it's a perfectly reasonable view, is the weakening of demand, rather than the weakness of the currency. That would justify tolerating the currency-driven overshoot of inflation. Indeed this may be the way the interest-rate market is thinking; the MPC should look through the inflation caused by the depreciation, even if it's boosting inflation at policy-relevant horizons. And if you take that view, and the deal turns out to be a good one, then you might pay more attention to any accompanying rise in business and consumer confidence than the likely jump in the exchange rate, even if it's a big jump. You would look through the prospective dip in inflation caused by a re-appreciation in sterling just as you did the inflationary impact of the depreciation.

However, I can also see circumstances in which the reconciliation is faster, exposing us to reversal costs. The negotiations are reaching a critical stage. If they go badly, and if even in December the EU decides progress is insufficient, the prospect of no deal looms larger even in the mind of the general public. And it is conceivable that, only a short time after raising interest rates, we would face an economy where growth began to stall and unemployment to rise.

I'm not suggesting that's the most likely outcome – the probability of this reconciliation delayed, more-of-the-same outcome, is probably higher. Nor am I saying that I won't be prepared to vote for higher rates next month. But I do believe we should think through very carefully all the various possibilities and craft our communications accordingly. And I am not prepared, as I said earlier, to support any change right now. My indicative vote is for no change in either rates or the stock of purchased assets.

Governor Carney. Ok, thank you Ben. Jan and then Michael.

Gertjan Vlieghe. Thank you. Last month I expressed a worry that it was difficult to tell a consistent story that fits both the GDP data, which show a marked slowing in the first half of the year, and the labour market data, which remain robust.

The news on the month seems to suggest that the puzzle is going to become smaller in the second half of this year, not because the labour market slows, but because GDP growth might be somewhat stronger than our forecast.

In the labour market data, we appear to be seeing a re-acceleration this year after the slowdown in late 2016, and this re-acceleration is consistent across both ONS employment data and survey evidence. This is putting the unemployment rate on a continued modest downward trajectory, once again confounding my expectations that it is about to stabilise. Over the course of this year so far, the strength in labour market quantities is probably the most significant upside surprise in the domestic data relative to my own expectations.

In addition to the strength in labour market quantities, the wages data are looking somewhat more encouraging than earlier in the year. After a very weak period around the turn of the year, the past four months have seen private sector wage growth averaging more than 3% annualised. These are volatile, and there is plenty of scope for them to disappoint again in the near term, based on past volatility. But all persistent accelerations must start with higher short-term growth rates, so at least we are moving in the right direction. And I also take some comfort from the renewed modest upward momentum in the pay component of the REC survey.

Turning to activity then, Q2 GDP growth was weak, as expected. Car sales exerted a big drag on consumption, offsetting strong retail sales. Looking ahead towards Q3, car sales look like they will make a positive contribution, simply by having bounced off the April lows. And retail sales look on course for modest growth. The net effect from just these two components is that I would expect consumption to be a little stronger in Q3 than in Q2. But this bean-counting exercise gives me little signal about what happens after Q3.

Similarly, using monthly output indicators, it looks like GDP growth in Q3 will be better than Q2, and above our August forecast, perhaps around ½% or so. Again, that's bean-counting, it does not say anything about subsequent quarters.

Two factors that do suggest some lasting upside risk to consumption beyond Q3 are the ongoing strength in employment growth, and perhaps the housing market. Persistent strength in employment growth underpins labour income, and labour income expectations. Regarding the housing market, it's early days, but several price and activity indicators look like they have bottomed out in the summer. I am not expecting a sharp recovery, but the news relative to my expectations is a small positive. That may tell us something about household sentiment and willingness to spend. Going in the other direction is the fact that consumer credit growth continues to decelerate, and credit conditions in this sector look like they might be tightening a little, which is a welcome development after the worrying further loosening of credit conditions and acceleration of credit quantities late last year.

I would summarise the data news on the month as ongoing strength in the labour market – against my expectations of a slowing – and some signs of rising near-term GDP growth – against my expectations of stable weak growth. And wage growth looks on track to beat our forecast.

Where does that leave me when I compare this news to my three markers for a rate hike that I laid out earlier?

One: are consumption prospects stronger than I expected? That looks like a yes, although some of the news is only relevant for Q3, rather than for subsequent quarters.

Two: is there a broadening of the strength in the business surveys beyond manufacturing? No. The services PMI ticked down for output, and up for expectations. The CBI services survey did the opposite. But these balances are not that far below their long-run averages and have been stable in recent months, so are not inconsistent with GDP growth being a little stronger in H2.

Three: are the higher-frequency wage data continuing at a pace of 3% or higher, or are pay surveys improving? That's a yes for wage data, and a yes for the REC pay survey

If the data stay on this trajectory for the coming months, which would not only confirm that Q3 is on track for an improvement, but that Q4 might be better than our forecast as well, that will be enough for me to justify a tightening of policy.

Looking at the bigger picture, the following considerations play a role as well.

The global growth outlook remains solid, and the absence of obvious sharp upward inflation pressure suggests that the world might be stronger for longer. That, combined with an end (or at least a pause) in private sector deleveraging in the US and UK, and an end to public sector deleveraging in the eurozone, might suggest that equilibrium real rates are rising slightly, and I want to emphasise slightly. I don't want to say normalising, because, first, as I am about to argue in my speech next week there is no normal. But second, even though the deleveraging drag is easing off, the drag from demographics is still set to get worse.

A completely separate consideration is one of monetary strategy as it relates to Brexit. I am well aware that there are phenomenal hurdles to overcome in the near term to keep Brexit negotiations on course for a smooth Brexit, by which I mean one with a lengthy transition period to a target regime that features low tariff and non-tariff barriers to trade with continental Europe.

As we have said many times, what matters is not whether we think these negotiations will go smoothly, but whether households and businesses behave as if these negotiations will go smoothly. Since the referendum, we have been generally surprised at the resilience of household and business spending, and I have been more surprised than most.

That resilience could change if there is a strong signal that negotiations are breaking down and we face the prospect of a cliff-edge Brexit, which in turn rapidly changes households' and businesses' willingness to spend now. This is not my central expectation, but it is clearly a risk. Unfortunately, such a rapid change in expectations is an event that could take place at any point until negotiations are successfully concluded. My sense is therefore that there is little monetary policy can do in anticipation. We will have to respond to it if it happens. And to be clear, we do not need to take a view on whether negotiations are going well or not. We need to take a view as to whether negotiations are having a material near-term impact on demand, in addition to the likely supply and financial market effects.

Absent the realisation of this risk scenario, the UK economy is experiencing reduced slack and some prospect of a gentle upward trajectory in wages. We are moving closer to the moment when some monetary tightening becomes appropriate. If the data continue to confirm this trajectory of reducing slack and rising wage pressure, I am minded to vote for a rate hike, possibly as early as November. Thank you.

Governor Carney. Thank you Jan. Sorry, I have Michael and then Andy please.

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

In the exceptional circumstances since the EU referendum, we have sought the appropriate trade-off between above-target inflation and below-potential output. The terms of that trade-off have continued to shift and the prospective trade-off is beyond my limits of tolerance.

Inflation has risen well above target, and the outlook is higher – and above target – throughout the forecast period.

At the same time, spare capacity in the economy has been absorbed faster than expected in recent quarters, with further declines in unemployment and under-employment alongside a renewed uptrend in survey guides to recruitment difficulties.

Moreover, the output gap is now probably very small. The jobless rate is below our estimate of equilibrium, while surveys do not indicate above-average spare capacity in firms. The net balance between under-employment and over-employment is close to zero – albeit not as stretched as the pre-crisis period. Inflation in the CPI components that are mainly driven by domestic costs rather than imported costs is within the margins of error around the target-consistent pace.

One view, as we have discussed, is that the recent strength in job growth just reflects a lagged response to the strength of GDP growth in late 2016. On this view, the recent slowdown in quarterly real GDP growth during the first half of this year would be likely to feed through soon to a marked slowdown in job growth and indeed perhaps produce rising unemployment, given that job growth usually lags real GDP growth by a quarter or two.

However, if this view was correct, one would expect to already see a marked slowdown in labour demand. There is little or no sign of this. Most business surveys suggest that firms' overall hiring intentions have strengthened recently and remain at or above average. I offer two explanations – they are not mutually exclusive – for this apparent puzzle between GDP and jobs. First, the recent GDP data may understate the economy's actual momentum, especially in manufacturing and construction where the surveys have been much stronger than the official data. Some of the recent weakness in official GDP data may be erratic, and reverse with a stronger quarter at some stage. And some of the recent weakness in GDP may, as often happens, be revised away eventually. Second, potential growth may be even lower than expected, reflecting the sluggish trend in productivity growth plus slower workforce growth due to reduced willingness of EU nationals to move to the UK for work.

With the slowdown in potential growth over recent years – and the possibility that potential growth is being further depressed by Brexit issues – I believe we should be careful not to automatically interpret the fact that some activity surveys are slightly below average as a sign that economic growth is below its current potential pace. Overall, business surveys at present are consistent with an underlying pace of economic growth of 0.4 to 0.5% quarter on quarter, or close to 2% year to year, similar to the last year or two. The consumer slowdown seems to be roughly balanced by gains in exports and investment. This pace of GDP growth used to be considered below trend but now is probably above trend.

The staff forecasts keep projecting that the jobless rate will level off at close to whatever is the prevailing level. By contrast, given the survey guides to activity and labour demand, plus the slowdown in inward migration, my hunch is that the jobless rate will continue to edge down in coming months and quarters, again undershooting our central forecast, accompanied by a further drop in under-employment. It seems likely to me that the output gap will be closed quite soon, if it is not already closed.

At the same time, sterling's depreciation is likely to keep inflation well above target for a while, even if domestic cost pressures do not pick up. In practice, the continued reduction in spare capacity probably will cause domestic cost pressures to gradually pick up. If interest rates were to follow the market path, I doubt inflation would return to target even once currency effects fade.

To be clear, my aim is to move from the current loose stance towards neutral, to ensure a sustainable return of inflation to target over time. If we are going to test whether the economy can sustain a jobless rate below 4½% without overheating, I believe we should do so cautiously – and with less stimulus than currently – especially given the prospect of an extended period of above-target inflation.

I do not want to dismiss the risks that we have discussed that the Brexit process might be bumpy, and this could undermine business and consumer confidence. In such a scenario, inward migration might also be lower, limiting labour supply and demand. I presume asset markets would also adjust, including sterling. The monetary policy implications of this scenario are not automatic, they could in theory go either way, and would depend on the combined effects on demand, supply, and the exchange rate. In my view, we should not maintain an overly loose stance as insurance against this scenario. Rather, we should be prepared to respond as needed if it happened, and we should state this clearly.

More broadly, I suspect the costs of policy errors and policy reversals have shifted compared to recent years. Over the last few years, it has generally been appropriate to err on the side of too much stimulus rather than too little. The economy generally had a significant output gap or – as in 2014, 2015 and early 2016 – below-target inflation, or both. Moreover, global growth was generally disappointing, providing downside risks to growth and inflation in the UK. Under those conditions, the costs of policy error were asymmetric: inadequate stimulus would leave the economy stuck in a disinflationary rut, whereas an overly loose stance would simply produce the desirable outcome of a faster closing of the output gap.

However, the current circumstances are very different in my view. As the expansion has progressed, the output gap is now small and likely to close soon. Inflation is above target and likely to remain so for a while. Global growth is stronger, deflation risks are less. The previous policy asymmetry no longer applies in my view.

Indeed, in these changed circumstances, in my view it now probably is less risky to hike than to delay, in order to provide more space for tightening to be limited and gradual. More importantly, this would allow the economy to have as soft a landing as possible during the Brexit process. Conversely, a strategy of keeping rates on hold until everything lines up, until pay growth has picked up to a target-consistent pace, would create risks that the eventual tightening might be rather less limited and gradual than desired, thereby leading to a more abrupt and painful economic slowdown. Thank you.

Governor Carney. Thank you Michael. And I, sorry I think you may have said it, but I'll take by inference that no change to asset purchases, you're minded to vote no change, but for a 25 basis point increase. Very good, so I have Andy and then Jon please.

Andrew Haldane. Thank you Governor.

The data presented at Pre-MPC brought home to me the widening gap between growth in the UK and the rest of the world, in particular for private final demand. Across the other G7 economies, private final demand has picked up pace through this year, rising by 1.4% in H1, its strongest since 2014. In the UK, private final demand was flat over the same period, its lowest growth since 2011. By historical standards, this UK-world divergence is only a little larger than normal, with the mean absolute difference in quarterly private demand growth around 1pp since 2000.

But what is perhaps more striking, and unusual, is the different slopes of these trajectories, with the world economy appearing to be on the upslope and the UK the downslope. Our models tend to suggest a relatively high degree of cyclical alignment between the UK and the rest of the world. For example, our in-house VAR models suggest that at least a quarter of all fluctuations in UK GDP historically have been sourced in global shocks and that a 1% rise in world GDP boosts UK growth by in excess of ½% through trade and non-trade channels. So what might explain this UK-world divergence?

Well perhaps the most reassuring explanation would be that UK growth in the first half of the year has simply been understated. There are enough straws in the wind to suggest this story has some legs. Output surveys have been consistently stronger than official GDP data, pointing to broadly flat rather than falling growth. Stronger still have been official and survey data on employment. These suggest, if anything, strengthening growth through this year. Interestingly, employment growth has shown greater alignment internationally, rising by 0.8% in the UK and by 0.7% in the rest of the G7 in the first half of this year.

If we were looking for potential sources of UK GDP understatement, one plausible candidate is net trade. This ought to have benefitted most from the effects of a weaker pound and higher world demand. Yet net trade, excluding valuables, subtracted from UK GDP growth by 0.2 percentage points in Q1 and 0.3 percentage points in Q3, as it has in all but one quarter since the referendum. As it happens, recent movements in export and import volumes are not greatly out of line with the predictions from our trade equations, once some allowance is made for a Brexit-related drag. Equally with past revisions to export and import data large and not typically offsetting in their impact on net trade, mismeasurement is also a plausible explanation. And consistent with that, export surveys point to materially higher growth over the past year, certainly in goods exports.

The alternative, less reassuring, explanation is that a Brexit-induced slowdown in consumption and investment has simply swamped any net trade benefit, leaving overall growth weaker. If so, a key question is whether this weakness will persist or worsen into the second half of the year. There are good reasons to think it might not, in particular for consumption.

First, the drag from lower household real disposable income was greatest in the first half of the year and is set to moderate into the second. It would be given an additional tailwind if employment growth continues to outperform, as the surveys suggest, especially as those new jobs tend to have higher marginal spending propensities than for existing workers.

Second, there are early stage signs that two of the larger contributors to weak consumption in the first half of the year – the car and housing markets – may be bottoming out. It is early days, but having together subtracted perhaps 0.4 percentage points from UK growth in Q2, the combined drag from cars and house prices is likely largely to have disappeared by Q3.

As our August *Inflation Report* forecast assumes consumption growth will remain at roughly the same subdued rates as in the first half of the year, the risks to this forecast seem to me to lie squarely to the upside. Perhaps more significantly, this could signal the UK economy gaining, rather than losing, momentum, albeit modestly, moving into the second half of the year. Last month, I said this was one of the pre-conditions for me voting to raise rates this year. And economic news since August, while mixed overall, has thus tended to strengthen my belief in the need for a rise in rates in the near term.

It is striking, and a little depressing, to find financial markets have reached the opposite view. Since August, the probability of a rate rise by year-end has fallen from around two-thirds to around a quarter, not much different than the time of the May *Inflation Report*. Some market commentary has also mean-reverted, with the perception the MPC will not raise rates this side of Brexit also on the rise. This appears to be not just, or perhaps not even mainly, a different view on the fortunes of the economy, on which reasonable people might disagree. Rather it appears, at least in part, to be a different view on the MPC's likely reaction function given the economy.

Specifically, financial markets appear to be placing a weight, a significant weight, both on a possibility of a Brexit cliff edge and on the MPC responding to this tail risk, actual or expected, by holding UK rates lower for longer. With economic news possibly slightly positive in net terms since August, it is this Brexit tail risk that seems largely to explain why UK yields are 17 basis points lower at the three-year horizon. It has also probably contributed to the sterling exchange rate being 2% lower.

One key question is whether that this is a sensible, or indeed accurate, view of the MPC's reaction function. For me, a more appropriate Brexit conditioning assumption for monetary policy in the immediate period ahead is the smooth transition path embodied in our IR forecasts as others have said. Put differently, any Brexit cliff edges or tail risks are probably best dealt with if and when they occur, rather than beforehand. The alternative seems to me to run the risk of the tail risk wagging the dog, potentially for many months to come.

To counter that, as others again have said, I think there is a case for seeking to clarify, in the MPS and minutes, that neither the precise timing of Brexit deliberations, nor the potential for Brexit cliff-edges, are factors which are pivotal to the MPC's decision on the preferred path of rates in the period ahead, except insofar as they affect spending by households and companies over that period. That clarification would helpfully reduce the chances of a sharper reaction in asset prices down the line, which would carry the risk of a more destabilising impact on confidence and spending.

As it is, the movement in asset prices since August has provided a further material dose of monetary stimulus to the UK economy which, taken in isolation, would put output above potential and inflation close to 2.4% at the three-year horizon. Taken at face value with no trade-off to manage, and with inflation materially above target, it's hard to see how this would not breach our already limited tolerance for inflation overshoots. It does mine. So the question for me this month is whether to vote for a rate rise now or wait until a fuller assessment in the November round.

On the one hand, a vote to raise rates this month can be justified, both in prospective output and inflation terms, but also as a means of helping prepare the ground in financial markets, thereby reducing the risk of a destabilising reaction later on.

On the other, some of the work in preparing the ground could be provided through other means, in particular by a suitably clear and strong signal on the MPC's likely reaction function.

There is also something to be gained by seeing whether those early stage signs of greater momentum in the economy, with a bottoming-out in the car and housing markets, and continuing strength in the jobs market, is maintained moving into the second half of the year, although I am also aware that this bias to inaction can be a cognitive weakness.

In sum, I am minded to vote to leave unchanged Bank rate and the stock of asset purchases next week, but will also want to reflect on what others have said today before reaching a definitive view. Thank you.

Governor Carney. Andy, thank you. So, Jon and Silvana please.

Jon Cunliffe. Thanks very much. Overall, looking back over the last year, the evolution of growth and inflation I think has been broadly in line with certainly my expectation. The strong growth we saw in the last two quarters of 2016 slowed to a more modest pace as exchange rate-driven inflation ate into household income. And, in my view, as the shadow of possible Brexit outcomes began to have some effect on business and household economic decisions and activity.

Headline data outturns since the August *Inflation Report*: the second release for Q2 GDP of 0.3% and July CPI at 2.6% have been in line with the forecast, and the now cast is now in line with our 0.3 forecast for Q3.

However, while the second release for Q2 GDP growth was in line with our forecast, the preliminary expenditure breakdown has not fully supported our narrative. Weak, indeed negative, net trade with almost no growth in goods exports, zero growth in business investment and consumption growth even weaker than our view which was already a downgrade on what the models were telling us. I don't want to read too much into those numbers, we know they get revised, there was a substantial positive allocation to the other category in this breakdown which probably will get reassigned and the trade number is counterintuitive. But, even if upgraded, these figures don't for me paint a particularly inspiring picture of the UK economy.

So in the light of this, how confident should we be about the outlook for Q3 and beyond? Has the slowing stopped, and are there signs of a bounce back, remembering that in our forecast we do have a mild pickup over the second half of the year with Q3 level at 0.3% rising to 0.4% in the fourth quarter.

There are four aspects of the recent news that could contain relatively positive signals for the economy, particularly for consumption. We are seeing signs that house prices have stabilised, not growing strongly but growing, and that approvals have also stabilised, and there has long been a correlation between house price growth and consumption for the UK. Second, the staff's new decomposition of household consumption suggests that the sharp fall in car purchases was a significant factor in the weak Q2 consumption growth, indeed was responsible for the gap between what the surveys were indicating or what the expenditure split has revealed. SMMT data for Q3 so far suggest that this will not be repeated so all else equal we may see some bounce back in consumption growth.

World growth has been relatively strong and that growth looks set to persist, which should support exports. And of course employment has been growing by 0.4% a quarter in the first half of the year. But, as the staff showed us, while there have been periods in which output leads employment – growth leads to job creation and recessions lead to unemployment – the data analysis does not support the opposite.

So this employment growth would not to me seem to signal an increase in output. Yesterday Andy took us through how growth and employment is an important component of growth in labour income, and that might suggest that the employment growth we have seen ought to be supporting aggregate household incomes and therefore might be expected to result in greater consumption growth, but the staff analysis I have just mentioned suggests that the macro data do not match up to that logic.

Recent pay data have been broadly in line with our forecasts. Whole economy total pay supplied to the upside at 2.1, but the strength was attributed to financial sector bonus. Regular pay also growing at 2.1%, a little bit below our forecast, with that weakness concentrated in public sector pay. While private sector pay was strong on a three month on three month basis. But today's numbers suggest a little less strong than we had thought.

This volatility is not unusual in pay, as we saw with discussing DGI measures last month. But a strong read could always be an early sign of strength to come and as Jan said if strength is going to come it has to start somewhere.

However I need quite some convincing before I believe that the tight labour market is leading to higher wage growth. There are a number of reasons for this, but one example was mentioned by the Agents at Pre-MPC, that there is now just a greater tolerance on inequality of pay within firms' individual awards rather that collective awards, for the drivers of pay growth now. For me that's an example of the greater divisibility in the labour market that Andy covered in his speech a few months ago. It means that the links between a tight labour market and pay growth, like recruitment difficulties or job churn are weaker than they were and so our interpretation of economic relationships may need to change too.

On the survey side the news is also weak for consumption. Consumer confidence has continued to drift down after falling sharply for a few months. While this could be read as only a little below a long run average, that average is heavily influenced by prolonged very negative readings within severe downturns. For more normal times the current reading for consumer confidence is really quite low. Inflation at 2.6% is also in line with our forecast, though mechanically adjusting the forecast for the news on the exchange rate and oil has lifted the overall profile, with inflation now peaking at 3.2% later this year, and ending the forecast period at 2.4%.

Of course this is just a mechanical update, but even so I think it's worth emphasising that in present circumstances we should be particularly careful about how we respond to changes in our forecast driven by exchange rate changes.

While is it difficult to estimate exactly how much, a substantial element to the exchange rate moves we have seen is in my view clearly connected to Brexit news. Sterling could bounce around a great deal as we get into the crunch period of negotiations. And I'd be looking for sustained moves in the exchange rate before I'd give too much weight to their impact on our inflation projections. In contract the oil related news for inflation is clearly telling us something, given it's related to a physical loss of supply. And of course the uplift in inflation profile is due to external rather than domestic news. I see no firm evidence that domestically generated inflation pressure is beginning to build up. So for all of these reasons the uplift in the inflation projection does not influence much my thinking on policy this month.

Turning to policy, I think it is worth reiterating my view on Brexit and my view on the forecast. On Brexit, withdrawal from the EU is within the forecast horizon and our forecast is conditioned on a smooth transition to our post-Brexit trading arrangements. A disruptive exit is not built into the forecast, nor is it built into my policy assessment, which does not include taking out insurance against a disruptive exit. But the shadow that Brexit, particularly a disruptive exit, may be casting now on economic activity does of course enter the forecast and enters my thinking. Clearly it affects financial markets, most obviously at present currency markets. And, though not to the same degree, it is in my view having some effect on business investment decisions and household confidence.

On policy and the forecast we said in August that if the economy evolved in line with our projections, policy could need to be tightened by more than the market at that point expected. The current market curve is not very different to August if anything a bit weaker. However for me the August MPS did not mean that a Q3 outcome in line with our forecast of 0.3% would trigger a rate rise.

We may want to give a signal this month, as we have discussed, about the way we see policy reversals, though I have to say, I am a little nervous about policy reversals still and would want to be careful about any signalling. But more importantly I for one would not want to imply that we are set on a rise in November if the forecast remains on track.

As for my policy this month, I am minded to vote for no change in interest rates and no change in the stock of purchased assets.

Governor Carney. Ok, very good, thank you Jon. Silvana and then Ian please.

Silvana Tenreyro. Thank you, Governor. Let me, you dropped something.

Governor: It doesn't matter. I don't know what I did but!

Silvana Tenreyro. Let me start by highlighting the positive developments on the international front. The recent upturn in global growth has continued in the past month's data. US GDP growth in the second quarter was revised up to 0.8%. Euro-area GDP growth also increased in Q2 to 0.6%, albeit by less than the August *Report* forecast of 0.7%. Japanese quarterly growth picked up to a surprising 1% in Q2, robust Chinese growth is set to continue, and growth rates in other emerging markets are broadly on track to meet our strong August *IR* forecast. Forward looking indicators are also encouraging, as shown, for example in various global consumer and business confidence measures.

While the global growth outlook is strong, the risks that concerned me in the last round have not gone away. On the contrary, North Korea and an even more likely US response might, at the very least, add uncertainty to the global outlook in coming months, possibly leading to trade disruptions and a worsening of the US debt position. And needless to say, an escalation of the conflict could dwarf any potential effects of monetary policy on the economy.

Other reasons for caution are the usual downside risks to financial stability in China and risks to political stability in the euro-area periphery; on the latter, October could be a decisive month for Spain if the referendum for Catalonian independence takes place.

Abstracting from downside risks, and with a focus on the central estimates, the global growth outlook should continue to provide support for UK aggregate demand, adding to the effects of a depreciated sterling. There is, however, reason for pause. The expenditure splits in the first and second quarters cast some doubt on a strong private demand narrative. Government spending accounted for almost all of the 0.3% growth in the second quarter and a large share of growth in the first quarter.

There is little sign yet in the hard data that either net trade or investment are responding to the positive global momentum. Business investment was flat against an expected growth of 0.8%, while net trade (excluding valuables) dragged on growth. Staff models of export volumes would have expected stronger growth given the depreciation in sterling related to the referendum. That has not materialised due to falling services exports, partly because these are less price sensitive.

Consumption growth fell back further than expected to 0.1% – driven in large part by weak car sales – and other consumption indicators were also somewhat disappointing, particularly when compared to their euro-area counterparts. Moreover, consumer credit growth appears to be slightly slowing down. There is some hint that housing market indicators could have reached a turning point, but it is a bit too early to say.

I am aware that the expenditure split is subject to revisions, so I am putting fairly wide standard errors on the figures. Still, the contribution to growth of total private demand – consumption plus investments plus net exports – in the first half of the year has been zero. On a more optimistic reading, one can also take positive signals from some of the near-term data. Output surveys for Q2 pointed towards stronger growth than the official data, which could signal future upward revisions to the latter. The strength in employment growth lends some support to this hypothesis. For Q3, the survey data so far are also consistent with stronger growth than the *IR* forecast of 0.3%.

Turning to the labour market, there has been positive news in the main labour market quantity indicators: Q2 total hours were higher than forecast in the August *Report* and the latest figures are broadly in line with that. Unemployment in Q2 was 4.4% as expected, and the latest data suggest unemployment will remain further below our estimate of the natural rate of unemployment, increasing the likelihood of a real wage growth pickup.

Despite the upside news on labour market quantities, earnings growth remains weak. Although bonuses were strong, regular pay growth, which gives a more reliable signal of underlying wage pressures, was slightly lower than expected at 2.1%. And the latest data released has not changed that picture materially. Incidentally, I think it is conceivable for the natural rate of unemployment to be below our estimate of 4.5%; this can be the result of, among others technological improvements in matching efficiency – the internet makes it easier to match vacancies and job seekers – as well as negative wealth and uncertainty effects impinging on labour supply, and putting downward pressure on wages.

Given stronger employment growth and unrevised GDP growth, one implication is downside news in measured labour productivity in Q2. One tentative explanation is that labour force compositional effects could now be dragging on TFP. That would imply faster than forecast growth in unit labour costs for a given rate of wage growth. But this is still tentative. Also tentative is the possible removal of the 1% cap in government pay, which could spill over to the rest of the economy, raising pressure on private sector wage growth.

Annual inflation in August was 2.9%, slightly above our expectations. Two external developments may have pushed up inflation, sterling and, more recently, oil prices. As a result, staff expected a somewhat higher near-term peak in inflation in October, but they expect the effect to be largely transitory. As was the case in the August *Report*, most of the inflationary pressure at the moment seems to be caused by external factors, rather than stemming from domestically generated inflation. Indeed, all DGI measures appear to be below target-consistent levels. This might change, of course, if wage growth starts picking up pace. But I am not convinced we are there yet. As for inflation expectations, most measures appear to be reasonably well anchored at present.

Let me now turn to the remit and wrap up. We have an outlook of above-target inflation and modest growth. The output gap is estimated to be small, though still in negative territory, which is consistent with the weakness in domestically generated inflation. As a caveat, standard errors around the gap are inevitably big. Moreover, inflation expectations appear to be well anchored. In light of all these considerations, my inclination is to wait for confirmation that private spending is not as weak as it appears in the official data and that real wage growth is more clearly in positive territory – or, at any rate, a clearer indication of a closing output gap before raising rates. The wait is of course conditional on inflation staying within current forecast parameters. So to conclude, I intend to vote for no change in the rate or in asset purchases.

Governor Carney. Great, thank you Silvana. So, Ian and then Dave please.

Ian McCafferty. My first thought on reviewing the economic news after the summer break was 'plus ça change, plus c'est la même chose'. Overall, it seems to me that the new information we possess does little to change the narrative in the August *IR*, and provides some further reassurance about the short to medium term outlook.

Probably the most notable news has been in asset markets, and in particular the further falls in sterling. Event studies can only tell us a partial story, and I suspect that more of the move has been driven by a broad rerating of the economic outlook for the euro area, and less by a calculated shift in the forex market's assessment of Brexit outcomes than the 50-50 split suggested at pre-MPC. The recent news on Brexit has been equivocal; on the one hand, it appears that not much substantive progress has been achieved so far; on the other, the degree of softening in a number of previous red lines in recent months may make an eventual agreement less difficult to achieve. The risks of a cliff edge remain, and time is slipping away, but it is too soon to make strong conclusions.

But the improved outlook for the euro zone economy has defied the sceptics, and survey and confidence measures point to that growth momentum continuing over the second half, at least. At present, I see few reasons why it might not persist into next year. First, in terms of shifts in r*'s across the globe, the eurozone probably has some of the better arguments to suggest that its r* has risen over the past year or so, as risk aversion has declined in response to banking reform, political developments and the gradual convergence between core and periphery economies, such that the current ECB stimulus has been sharpened. Second, I suspect that we will eventually discover that U* in the eurozone is rather less than 9%, such that the current pace can be sustained for somewhat longer.

For fundamental investors, this rerating of the eurozone has taken some time to be confirmed, and is probably still underway, which may suggest that recent currency moves have further to run.

That improvement in the outlook for the eurozone, combined with the relatively upbeat news from elsewhere in the global economy, suggests that the upgrade to the global outlook contained in the August *IR* may yet prove to be too modest, although, for now, given the geopolitical downside risks present this month, I am happy to leave a stronger global recovery simply as an upside risk in my assessment.

In terms of the news on the UK real economy, that has been more limited, but on balance continues to support the underlying narrative of the August *IR*. Last month, I raised the question of whether the glass was half empty or half full. That is: does the evidence point to an economy that is in the early stages of a marked and persistent slowdown, or to one that retains momentum, albeit, as expected, at a pace somewhat more moderate than that which we enjoyed last year?

Well, the latest estimate of Q2 GDP and its expenditure components can be read either way – aggregate GDP growth was in line with expectations, but the expenditure breakdown disappointed. However, given the inexactitude of the early expenditure components, the seemingly idiosyncratic performance of the car market, the tentative signs that the housing market is holding up and the persistence of the signals of steady activity contained in the business surveys, I continue to believe that the Q2 GDP data overstates the degree of slowdown underway.

This conclusion is backed up by the signals from the labour market. In recent months, employment growth has accelerated, after the pause between September and January, and according to the latest REC survey, demand for staff continues to increase. As a result, we are now starting to see more of a response in wages, with the three month on three month increase in private sector regular earnings for June rising to 3.7%. So far, this is only one quarter, and the series is volatile, but with only subdued productivity growth, nominal wage growth at this rate is already faster than consistent with the inflation target. Big picture, it appears that the pause in employment growth that characterised the latter part of last year, and the slightly lagged pause in wage growth that lasted until the spring – both probably a reaction to the surprise of the referendum result – have now ended, and growth in both employment and wages is being restored to levels more consistent with continued moderate growth in activity and little labour market slack.

The labour market data also show that recruitment difficulties and skill shortages remain acute, such that I retain my view that there remains very little slack in the economy. The pace of projected growth is therefore sufficient, in my view, to close the remaining output gap somewhat earlier than envisaged in the August central forecast.

This judgement somewhat simplifies my policy stance, as it effectively removes the need for trade-off considerations. With the further fall in the exchange rate leaving inflation slightly higher than in August at both two and three year horizons, the argument in favour of a modest tightening in policy, ceteris paribus, is concomitantly a little stronger than it was last month.

Of course, other things are seldom equal, and the intensification of the Brexit negotiations provides both the potential for significant downside risk as well as the possibility of further information about the nature of UK withdrawal in the relatively near future. So why move now, rather than waiting a little longer?

The arguments for waiting are, for me, less than compelling:

One, I suspect that Brexit developments in Q4 will be less than clear-cut, and that a muddle through is the most likely outcome, somewhat reducing the risk of an immediate crash out, but leaving uncertainty as to the eventual nature of trade relationships after exit still high.

Two, setting policy on the basis of such event risks, even as significant as a Brexit crash-out, is problematic, as the calibration of both magnitude and timing is extremely difficult. For me, such political event risks carry much lower policy reversal costs than other developments. If and when such events materialise, it is clear to all that the economic and financial outlook has significantly changed, such that we would be expected to deliver an active policy response.

And three, I am not as convinced as Ben that the differences of view about Brexit between consumers and businesses on the one hand, and foreign exchange markets on the other, are such as to risk a sharp and disruptive reconciliation which would necessarily be disinflationary.

There is also a danger that, because we are close to the Brexit process, and have strong views, we depart from our normal convention of setting monetary policy on the basis of stated and settled government policy. We do not anticipate changes in fiscal policy before they are adopted; unless and until the government changes its ambition of a smooth exit, I believe we should continue to both produce our forecast and set policy on the basis of a smooth transition to whatever the new arrangements may be.

Those are the arguments against undue delay; there is a further one, in my view, in favour of starting now – it affords the greatest degree of gradualism. I am of a similar view to everyone else on the Committee, that, absent large moves in r*, we are anticipating only a modest tightening of policy over the forecast horizon, of less than 100 basis points in aggregate. But I would prefer that even that modest tightening were undertaken as gradually as possible, to allow agents in the economy time to adapt between each move, as well as allowing us to assess whether responses to increases in Bank Rate have changed in the decade since we last put rates up.

As a result, I am minded to continue to vote for a 25 basis point rise in Bank Rate, and no change in the level of asset purchases, of either corporate bonds or gilts.

Governor Carney. Thank you Ian. So Dave Ramsden please.

Dave Ramsden. Thank you Governor.

Just as much of my work at HMT has focussed on scenario analysis of counterfactuals, what if exercises, so also on many occasions over ten years of sitting in the Treasury representative's chair, I've considered the what if that I would join the members in voting.

Given the multiple challenges, uncertainties and the sharpness of the trade-offs at present it would be easy to conclude this was a case of be careful what you wish for. This isn't the case for me at all. Over and above all of the high quality help, advice and support I've had from my new colleagues this week, and in the run up to starting, three features provide particular assurance for me as I look ahead to the monetary policy decisions I now have to make next week and in the period ahead.

First, our remit gives us the right framework to work with, and since 2013 makes specific provisions for exceptional circumstances. Though it's fair to say that when we revised the remit then, we didn't have a shock like Brexit in mind.

Second, I think the collective assessment of the Committee as to the outlook, as set out in the August *Inflation Report* forecast and the judgements and assumptions embodied in it, is a good starting point for the key judgements we have to make about the balance in rotation of demand, the supply outlook and what that implies for wage cost and the pressures and the outlook for inflation

Third, given the myriad uncertainties, while there is consensus around the current guidance that rate rises will be limited and gradual, I am not surprised that judgements differ sufficiently on the appropriate monetary policy response for there to have been a split vote in August and an emerging one this month on the appropriate level of Bank Rate. I will endeavour to do what I can to add value to that current mix.

Now not that much time has passed since the August round and I don't think the news on the month has changed the bigger picture of the fundamental trade-off between slack in the economy and inflation pressure. And I also think it continues to support the narrative. But bottom up there are rather more moving parts, many of which do relate to our key judgements and I would like to flag some of the key considerations from me from what I thought was a good set of Pre-MPC presentations and a good discussion yesterday. As Jeremy's Pre-MPC presentation brought out well, quite a lot has happened in financial markets. Risk-off flows linked to rising geopolitical tensions have interacted with rather good news in the global economy, particularly from the euro area, plus some UK specific and Brexit related impulses, such that we have quite a bit of news on UK asset prices. The upside news in many G7 economies on growth so far in 2017 is, as others have pointed out, in marked contrast to the slowdown in the UK, where there is accumulating evidence I think of a slowdown in final demand.

Turning to the UK, I was reassured by presentation on trends in credit and that where there may be new developments – such as potential upside news on housing but also possible tightening in SME credit – we are vigilant to those developments and the risks that may go with them.

It is frustrating that we don't have good quality data on business investment and especially trade to be able to track our rotation of demand judgement in anything close to real time. But even allowing for data uncertainties, private demand does look weak to me. Consumption is the most solidly based component at this stage. An effective case was made at Pre-MPC for why consumption might have been unusually weak in the first half of 2017, and why we might see a pickup, albeit to still modest growth rates. Business investment does see big revisions but there's no trend to those revisions, unlike with trade, and alongside softer survey indicators the latest data are consistent with a chilling effect from Brexit uncertainty, particularly on new investment prospects and perhaps more so in services.

However we need to remind ourselves that in output space, Q2 GDP ended more strongly, driven by the index of services. And, if sustained in the July numbers, the handoff to Q3 could give us an upside surprise to our GDP forecast of 0.3%.

Like others I will be looking closely at labour market developments as these, as always, will be central to how the economy evolves and our policy response. At Pre-MPC, I thought set out clearly the staff analysis suggesting the divergence between employment and growth is not that unusual, obviously given the recent performance of productivity. And, despite repeated disappointments, I have tried to retain an optimistic outlook about productivity. And in the short term I still expect to see employment growth slow in response to the weakness in output growth we have already seen. However the pre-MPC analysis of compositional effects on earnings and Andy's presentation yesterday are the latest challenges to that view.

The supply side of the forecast will be a particular focus for me in the November round, and I expect to learn a lot about our approach and the range of views across the Committee on slack. My starting point is that there is at least as much slack as in the August *IR*.

Looking at headline inflation, in the immediate future the latest OPEC news and hurricane-related supply shocks to oil prices, put us firmly back into letter writing territory this autumn – as if there wasn't enough else going on in the coming period. However, my main case remains that, even after taking into account the latest depreciation, and the CPI data, the further pickup in inflation ahead will be more like a peak than a plateau, conditioned of course on Brexit and other assumptions. And this was reinforced for me by the two pre-MPC presentations from the Agents, which did give me some insights on the drivers of margins and wage behaviours in firms, underpinning that key relationship between conditions in the labour market and pay growth, where I see pay picking up in line, pretty much in line with the August forecast.

Now let me put all this together. With Brexit we are living the counterfactual, and with a shock which is a process generating a whole series of events. It seems to me that Brexit and the evolution of the economy are increasingly linked as the impact of the exchange rate fall and some of the as yet unknowable effects of Brexit are experienced or anticipated by households and businesses. Now our approach to dealing with this – boiling it down to its impact on supply, demand and the exchange rate – works well for me. And it is entirely consistent with the obligation in our remit to, in exceptional times, balance the trade-off between the speed at which inflation is returned to target and the variability of activity.

Now, as our forecast suggests, were developments over the crucial coming months of negotiations sufficient to give confidence that a cliff edge would be avoided, some kind of deal struck, then it would materially increase the chances of the rotation into investment and exports materialising alongside some continued growth in consumption. And, as also embodied in our forecast, we could expect slack to be eroded, and the trade-off that we have been trying to balance would disappear. Of course, in that case, it would be much harder to argue we were in exceptional circumstances. Overall a faster pace of tightening would be warranted than is currently suggested by the yield curve. And, as a communications device this month, I think the asset price news on the month would be a good hook on which to re-emphasise this point about financial market expectations from the last two forecast reports.

But it seems to me clear to me that as things currently stand Brexit is casting a shadow over the economy, as I do take some signal from the consumption and investment indicators for Q2, with 0.1% consumption growth being particularly notable. And, while there are reasons to think that Q3 may be stronger, and in arithmetic terms could surprise on the upside to our forecast, this wouldn't by itself be nearly sufficient for me to lighten the shadow of Brexit on activity.

It seems truer than ever to say we will learn a lot over the coming months. I will continue to pay particular attention to the combination of news coming from the data and from the Brexit negotiations. And, speaking individually, I am looking forward to learning much more about what underlies the forecast, and applying that knowledge to the unusual circumstances we face.

But in terms of my indicative policy decision for this month, it is for no change in Bank Rate and no change in the stock of asset purchases.

Governor Carney. Ok, great, thank you very much Dave.

Last meeting I said that, given the modest overshoot of inflation at the two-year horizon and given that that was caused by a fundamentally driven depreciation of sterling, given the move to sluggish growth and the prospect of some tightening of financial conditions due to the actions of the FPC and PRC, I didn't favour removal of monetary stimulus at that meeting, apart from the pre-agreed, or confirming the termination of the TFS in February.

I noted that the greater uncertainty from the election and the start of Brexit negotiations made me somewhat less confident that business investment and net trade would grow strongly enough to offset any weakening in household spending. But I explicitly said I did not want to throw in the towel yet on either that rotation or the possibility that household demand would reaccelerate following a pause and certainly, to the extent to which Brexit prospects appeared to be smooth, again going to expectations of agents, both were plausible.

I concluded that, if in the coming months growth prospects firmed once again to above trend rates, I would favour withdrawing some monetary stimulus, possibly as early as November, while stressing that increases in Bank Rate would be at a gradual pace and to a limited extent.

Since that time, as others have noted, there has been limited data and, with most outturns close to expectations, even more limited data news.

There has also, such that there has been news, there's been limited evidence of a rotation of demand. Official data, for what they are worth, which is little at this stage, give no comfort on that front, but growth still appears to be tracking in sight of its diminished trend.

Business surveys, as others have noted, have been more constructive, particularly on expectations balances, and especially for the CBI. I'm somewhat more pessimistic now on investment than I was before, but somewhat more confident that household consumption may hold up for longer given continued strong employment growth, early signs of a wage pickup and even earlier signs, at least to my eye, of a potential trough in the housing market.

The strength of the global economy remains on track, although it's not clear the extent to which the UK is benefitting from it. Its strength is broad based; there is expenditure, trade and capital goods data which all suggest the rotation towards business investment globally is proceeding, consistent with a more resilient expansion, and that solid growth in business investment also raises the prospects of a gradual rise in r* and an increase in monetary policy traction in a variety of jurisdictions.

In contrast, the Brexit negotiations are predictably off track. There's no sign of the necessary linkage being established between the separation issues, the future relationship and transition. I'd note that financial stability risks, which we will have a chance to discuss at the start of October, are increasing in tandem.

I won't do a detailed decomposition of sterling weakness. I think there's arguments on all sides. I, in general feel that it's more that the currency's been caught between euro strength and dollar weakness in an environment where remain-like Brexit outcomes have also risen alongside and both tails have gotten fatter.

But we're in a situation where cliff-edge risk feels uncomfortably high. I'd put it at more than a quarter and a key consideration is how that influences current monetary policy; in other words, when is a tail not a tail?

I would expect going over the cliff to be broadly disinflationary as households and businesses arguably have more to adjust towards the exchange rate than the exchange rate does to be consistent with a WTO scenario. In short, the demand shock would weigh more heavily than the supply shock.

In contrast, I expect most other scenarios to be mildly inflationary, reflecting the fact that a smooth Brexit will represent a negative supply shock, mitigating the disinflationary effects of weaker demand. And I'm going to give a speech on this in a few weeks. So I won't bore you with the details. Although I almost did because I brought my [inaudible]. But there is little point in anticipating these outcomes, unless and until they become the central case over the policy horizon. And so turning to today's decision, most of the limits to our tolerance, our express limits to our tolerance for above-target inflation, have not been tested. Inflation expectations remain well anchored. There have been no second round effects from elevated inflation; in fact there's been some evidence of a risk of a Brexit miasma hanging over wages. Consumer spending has slowed as expected and sterling's depreciation is passing through and boosting prices broadly as expected.

But there's one important exception to all of this, which is that the current trade-off is disappearing. In other words, the reason for the tolerance is going away, and we're left with a fairly persistent inflation overshoot.

Slack is continuing to narrow, to my judgement. There is further upside news on labour market quantities and employment surveys continue to be strong. And there's an emerging downside risk to imported labour supply, and potentially to contestability, which comes from that, and there's no sign, not that anyone would really be expected in the short term, there's no sign that productivity growth has picked up.

The inflation overshoot is likely to become more significant, partly reflecting the exchange rate, partly reflecting petrol prices in the short term. We'll be in letter-writing territory in October and the three-year inflation rate is mechanically I would say, at 2.4%. I think we are, I agree with Jon, we should be careful about, and we are careful about, reacting to shorter-term volatility in sterling, we're going to see, continue to see a lot of it. I did take something from the Agents' insights on margins and our previous general lack of justification for our tweak on margins other than signalling, to suggest there's some offset to this overshoot, and I do see underlying domestic inflationary pressures as relatively modest although picking up, the prospect for their picking up over the policy horizon continues to build.

I said in August, given the modest outlook for supply, even a limited pickup in growth from rates in the first half of the year would, in my judgement, merit a modest tightening of monetary policy. That case is reinforced by the possibility that r* may be increasing so that monetary policy has to move to stand still.

At this meeting, I am minded to vote for no change to Bank Rate or asset purchases. My decision reflects the value of gathering more data in the run-up to the November *IR*. And I'll be looking in particular for confirmation that consumption growth troughed in the second quarter and that directionally the pickup in wages isn't another false dawn. So not setting a precise number on it.

My conditions for voting for an increase at the next meeting are that indicators of growth are picking up broadly as expected and that Brexit negotiations do not massively and publicly derail such that they affect consumer and business confidence.

So if that, maybe I'll just say a couple of words on communications and we'll have a chance to, and obviously we'll have to, finalise our views next week and then sit down and work on this. But some of the things that we talked about yesterday and I heard today, that merit mentioning, apart from the usual issues around exceptional circumstances and trade-offs, is that there is substantial uncertainty about both the end state of the Brexit negotiations and the transition to it, and what matters is the impact of those negotiations on the inflation outlook and that is determined by their impact on the expectations of households, businesses and financial markets.

Secondly, that those expectations have been consistent, or appear consistent, with an economy growing at rates consistent with its reduced, that is modest, growth rate of potential. Now, various people would differ on words and so I'm just concepts here, with the further closing of the output gap and the effective, or the prospective, disappearance of the trade-off, it is becoming less appropriate to tolerate a sustained overshoot of inflation of target.

If the economy continues to follow a path broadly consistent with the August *IR* projection, then some withdrawal of monetary policy stimulus will likely be appropriate and then the question is whether one says in the near term in order to return inflation to target in a sustainable manner, and I'm picking up a bit on Andy and Jan's and others' comments. I wouldn't say that that's a universal view, but I would be more in that camp. It's a big signal and we have to look at it on the page and decide whether it's appropriate. I think we'd have to follow on with saying, if there were material developments in the Brexit process that change the outlook for inflation and growth, monetary policy would be adjusted accordingly. For those who want, and I see some merit in this, for those who want to discuss the costs of reversals, I think that would be more appropriate at some point in the minutes, as opposed to in the policy section of either the MPS or the immediate policy decision.

I'd just make a couple of comments, slightly abusing my position here, but just the comment on government policy, whether or not we, I think this is different. Government policy is an aspiration to say that we were going to have a bold comprehensive objective everything, you know we're going to have cake and eat it too, that's an aspiration. That's not the same as having a budget, where the government has a budget, passes the budget, tax and expenditure things move with it. So I don't think, there are certainly scenarios where there is just a huge disconnect between what the government says it wants and what the government can achieve and that flows through. Now I think we're flowing it through the expectations of businesses and households, to some extent that gets us out. But I wouldn't, personally I don't think in this one that we can always mechanistically follow through with that. In fact we'd have a much stronger forecast if we were following government policy and they were delivering that.

And then the other thing is just in terms of, as we work through thinking about communications, assuming we are broadly in this place next week, part of this, if there's a signal, I think is to try to keep it as simple as possible, which is to emphasise that demand is growing, or is expected to grow, relative, the emphasis on demand relative to its diminished rate of growth of supply, so that the gap is closing. There was a trade-off, the trade-off has been eliminated and don't think old demand think, sorry don't think old supply, think new supply. And this is about the sustainable return of inflation to target. And as much as possible, and this is the last thing I will say, I would like to avoid getting caught in an MCI type scenario, so too much emphasis on exchange rate leads to you reacting to the exchange rate. You are reacting to petrol price, you are reacting to a short, to the very near-term, overshoot, which given all the other, well put it this way, because the transcript doesn't come out for a while, but relative weaknesses of the UK's position is a very dangerous thing to get caught up, so with that.

So I should try to summarise, what I would summarise, I'm going to do two summaries, if you'll forgive me.

The first is on the immediate policy decision, we have seven votes to maintain Bank Rate at 25 basis points and two votes for an immediate, indications I should say, indications for 25 basis points, two indications for an immediate increase of 25 basis points to Bank Rate and then we have nine votes to maintain the stock of asset purchases – both corporate bonds and gilts, the current level and no votes to change that.

I would say we have, and this is the other thing, just to guide communications, the communications discussion, I would say we have an indicative majority for some sort of signal to move in, that we would move in November if the outlook if developments were consistent with the August forecast. That is not a, I said majority not everybody. But we can thrash that out after the final decision and communications.

Ok with that, if everyone's ok with that, I don't think we have any other business, no, so we'll close this off.

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

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

Richard Hughes was present as the Treasury representative.

The following members of staff were present:

James Bell, Director, Monetary Analysis
Alan Castle, MPC Secretariat
Sarah John, MPC Secretariat
Chris Young, MPC Secretariat
Melissa Davey, Editor of *Inflation Report*

Transcript of the Monetary Policy Committee Meeting on Wednesday 13 September 2017

Governor Carney. Ok, good afternoon everyone, so welcome to this Decision Meeting. We will start with an update on market developments. There have been some, so I'll turn to Dave and then I'm going to go straight to Andy for the recent data please. Dave.

> **Dave Ramsden.** Thanks Governor. Markets have seen an improvement in risk sentiment since the Deliberation Meeting cut-off and easing in acute geopolitical tensions around North Korea and an agreement to suspend the US debt ceiling by three months providing the initial catalyst for the shift. The last few sessions have also brought a reassessment of the outlook for policy rates, including for the MPC. While the shift higher in rates started with US global considerations, underlying UK specific elements have since taken hold. Market contacts have highlighted prospects that the MPC could outline a more forceful case for rates rising faster than the prevailing market profile. Meanwhile, the stronger than expected August CPI print led some to think it could push the MPC's inflation projections higher. Slightly below consensus wage data has only offset these moves to a degree. A first full rate rise has now been brought forward to August 2018, from September 2019, while the implied probability of a move by the end of this year is now 40%, having been around 20% previously. The rates moves have brought the market curve more or less back into line with the profile in the August *Inflation Report* conditioning path. At the same time, sterling has rebounded alongside the move higher in rates and as such is now only 0.5% below the 15-day average used in the August *Inflation Report*.

Governor Carney. Thank you. Andy.

> **Andrew Haldane.** Internationally, the only piece of bit of data I would mention would be euro-area industrial production for July which is up 0.1, a shade less than we'd expected. As a result of that we've nudged down our Q3 forecast for the euro area from 0.6 to 0.5. And then domestically, last Friday when we met, last Friday morning, we had industrial production, construction and services turnover. Industrial production and services turnover were broadly in line with our expectation. Construction came in a bit shy, which provides a little bit of downside news to our Q3 now cast though for the moment that remains at 0.3. We have had trade data for July, with goods exports picking up, more than offsetting the weakness in May and June. Imports also up, though a bit less than export volumes on the goods side. And then finally, we have had a range of housing market data, both prices and quantities. That tends to confirm the picture of something of a stabilisation in the housing market, for example, with completions, approvals and transactions all up a touch in July. That's all, thank you.

Governor Carney. Ok. Good, ok. With my earlier proviso on order, I'm going to invite votes on the following three propositions. The first, that Bank Rate be maintained at 0.25%. The second, that we maintain the stock of sterling non-financial investment-grade corporate bond purchases financed by the issuance of central bank reserves at £10 billion. And thirdly, that the Bank of England maintains the stock of UK government bond purchases financed by the issuance of central bank reserves of £435 billion.

So I will start with Ben, please.

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

Governor Carney. Ok, Jon, sorry, Jan Vlieghe please.

> **Gertjan Vlieghe.** I vote in favour of all three propositions.

Governor Carney. Michael?

> **Michael Saunders.** I support the propositions on asset purchases, but on Bank Rate I'm voting for a 25 basis point rate hike.

Governor Carney. Thank you. Andy.

> **Andrew Haldane.** I support all three propositions.

Governor Carney. Jon.

Jon Cunliffe. I support all three propositions.

Governor Carney. Thank you. Silvana.

Silvana Tenreyro. I support all three propositions.

Governor Carney. Ok. Ian.

Ian McCafferty. I support propositions two and three on asset purchases, but vote for a 25 basis point rise in Bank Rate.

Governor Carney. Thank you. Dave.

Dave Ramsden. I vote in favour of all three propositions.

Governor Carney. And I vote in favour of all three propositions as well.

So, by my reckoning, that is seven votes in favour of the first proposition to maintain Bank Rate at 25 basis points and two votes, Michael and Ian, both in favour of a 25 basis point immediate increase in Bank Rate. And then nine votes in favour, no votes against, the other two propositions, namely to maintain the stock of corporate bond purchases and to maintain the stock of gilt purchases. Checking that that's correct. Ok. Very good. So with that, I will close the formal part of the meeting, we're going to discuss the plan for the forecast and then we'll go downstairs and do the minutes.