BANK OF ENGLAND

November 2021

Monetary Policy Report

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Huw Pill
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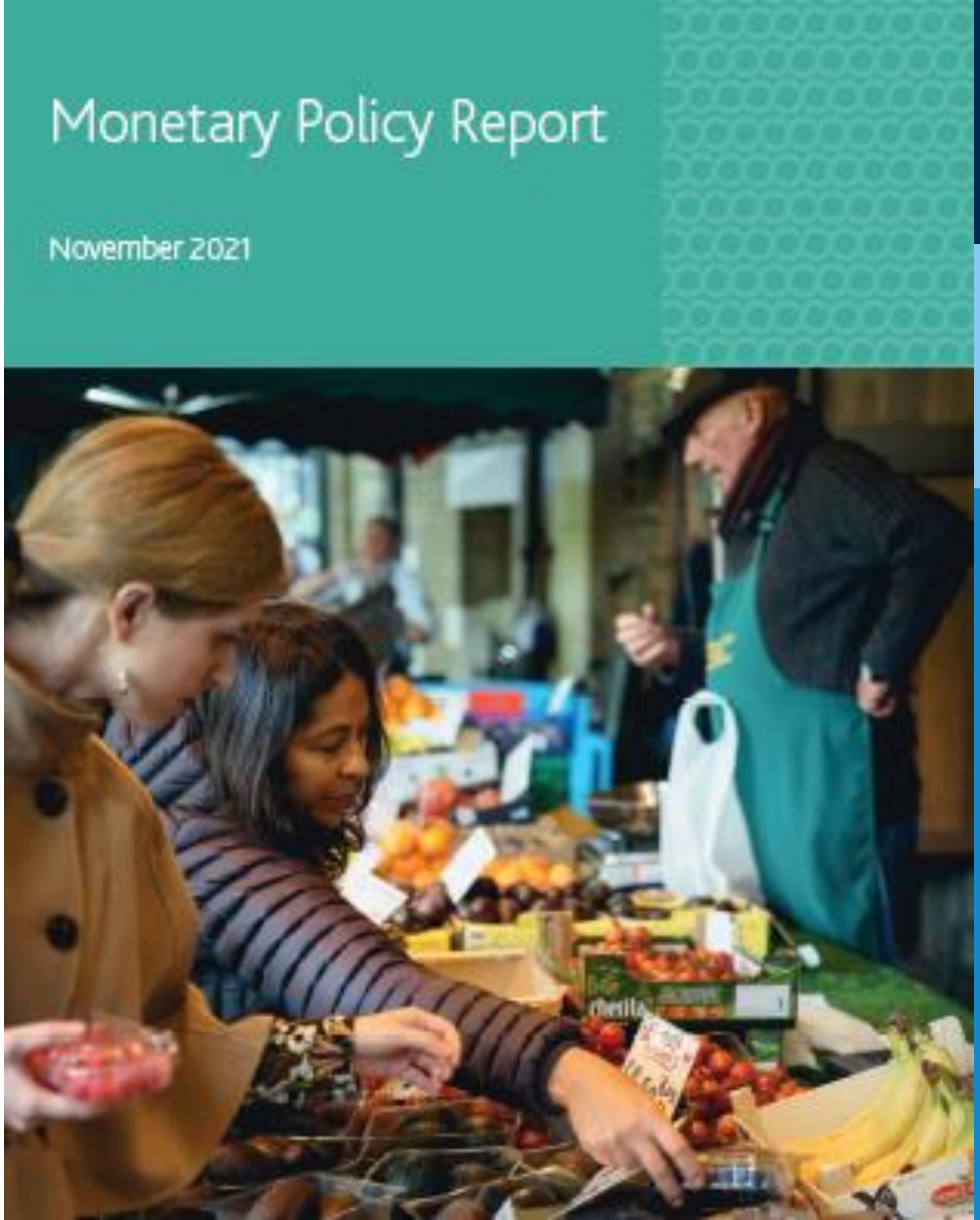
Friday 5 November 2021



Plan for the session

- Scene Setting (Becky) – 5 mins
- Quick tour of the Report (Huw) – 20 mins
- Q&A with Dave and Huw (please submit your questions via chat box and Becky will ask them) – 35 mins

Quick tour of the Report

Headlines

Report in a nutshell

The UK economy continues to recover from Covid

Higher energy and goods prices have pushed inflation above our 2% target

We expect inflation to rise to around 5% in the spring, but then fall back

We expect interest rates will need to rise modestly to return inflation to our 2% target

Forecast summary table

Table 1.A: Forecast summary[a][b]

		Projections			
		2021 Q4	2022 Q4	2023 Q4	2024 Q4
GDP[c]	*annual growth rate, %*	6.7 (8.5)	2.9 (2.3)	1.1 (1.3)	0.9
CPI inflation[d]	*% per annum*	4.3 (4.0)	3.4 (2.5)	2.2 (2.0)	1.9
LFS unemployment rate	*% of labour force*	4.5 (4.8)	4.0 (4.3)	4.1 (4.3)	4.4
Excess supply/Excess demand[e]	*% of GDP*	+¼ (+½)	+¼ (+¼)	0 (0)	-½
Bank Rate[f]	*market-implied, %*	0.2 (0.1)	1.0 (0.3)	1.1 (0.5)	1.0

- Growth weaker in the near-term, stronger in the middle, and weaker again at the end
- Higher near-term peak for inflation, below target by the end
- Excess demand initially, but excess supply by the end – also reflected in unemployment
- All dependent on a path for Bank Rate that rises quickly to 1%

GDP and unemployment outlook

Chart 1.1: GDP projection based on market interest rate expectations, other policy measures as announced

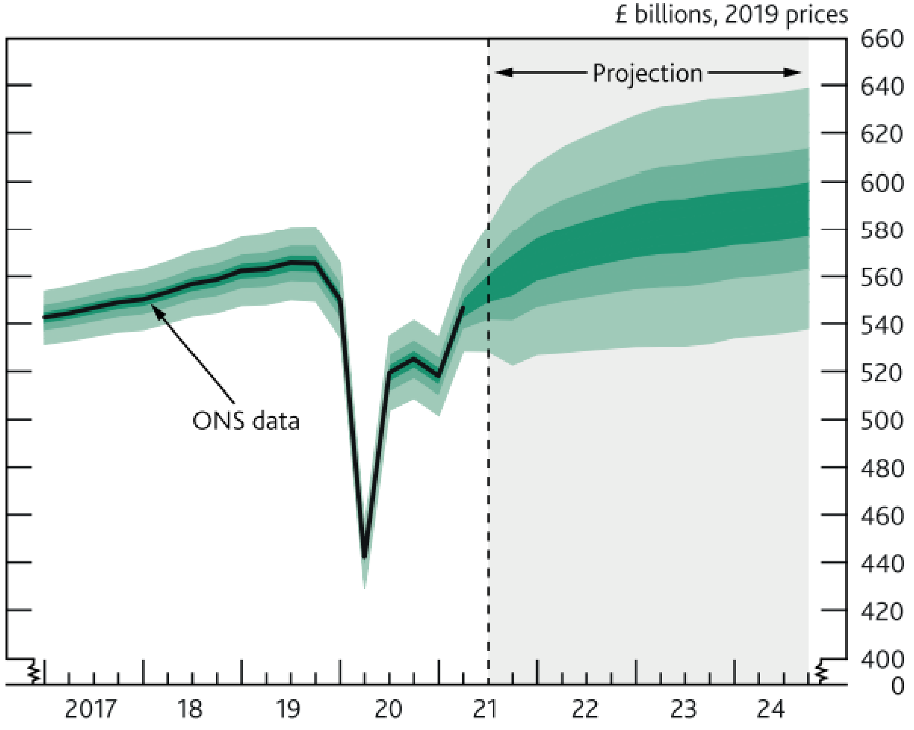
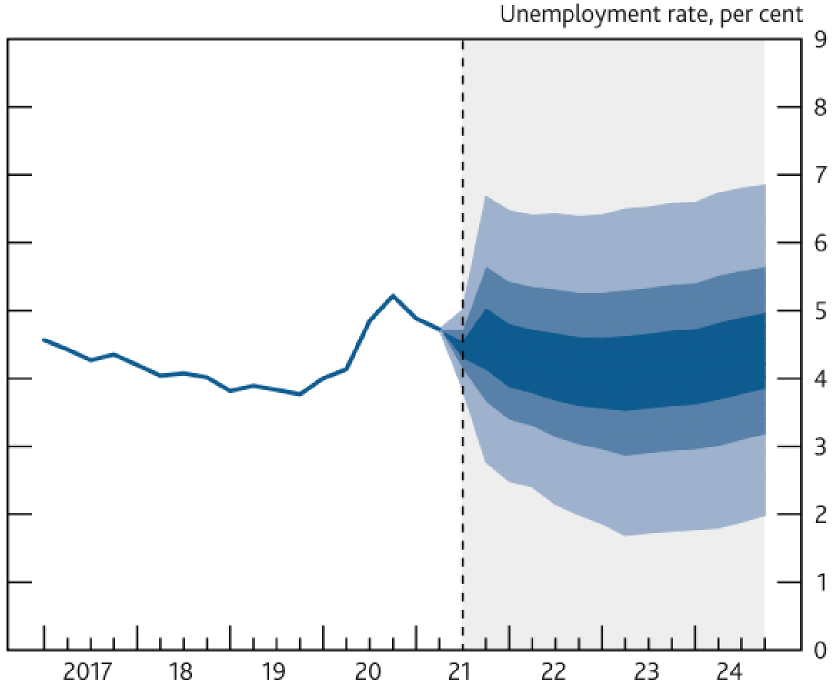


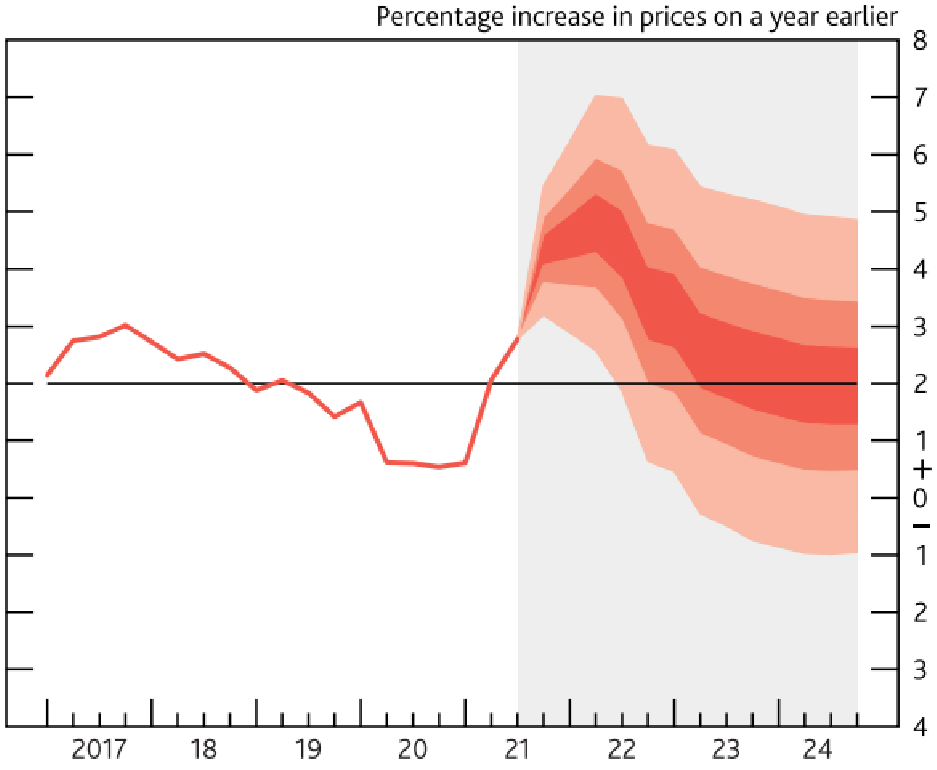
Chart 1.3: Unemployment projection based on market interest rate expectations, other policy measures as announced



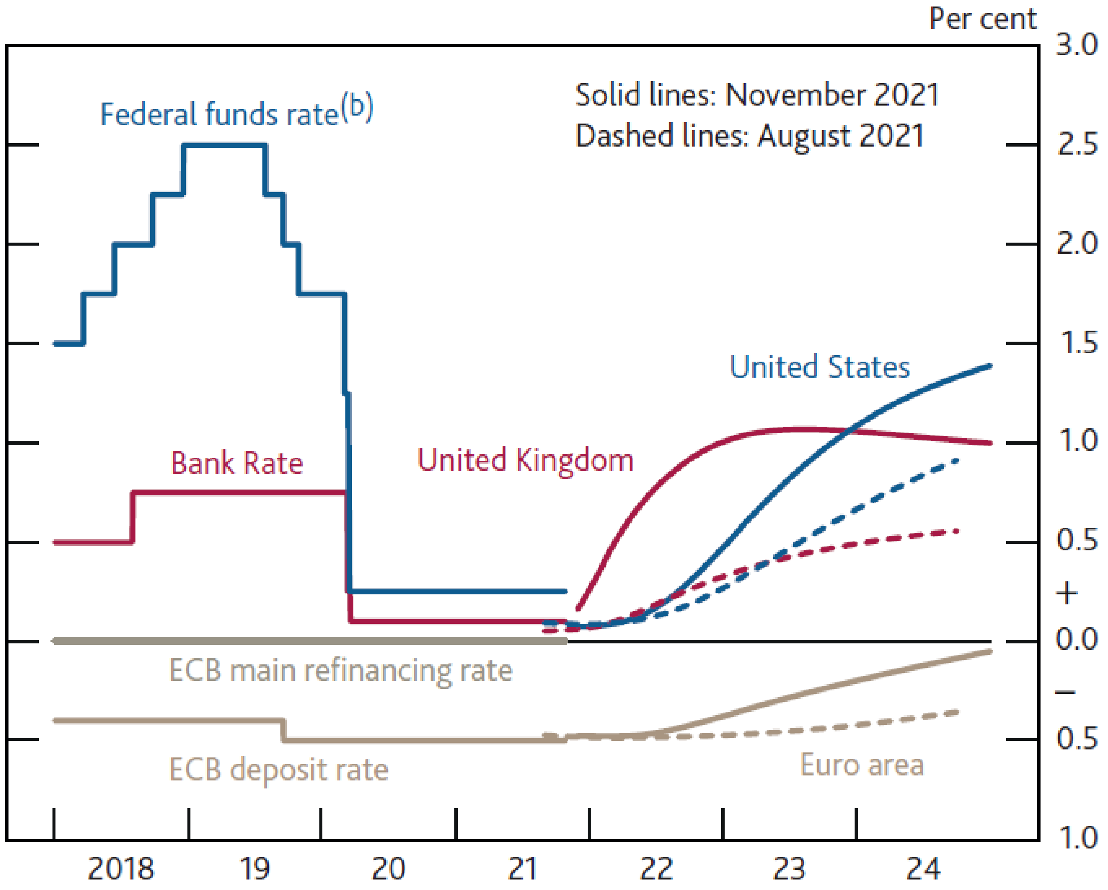
- Growth slows as the boost from reopening ends and by the end of the forecast is below potential rates reflecting the drags from energy, and waning fiscal and monetary stimulus
- Reflecting this, unemployment begins to rise by the end of the projection.

Inflation outlook and interest rate assumption

Chart 1.4: CPI inflation projection based on market interest rate expectations, other policy measures as announced



International forward interest rates(a)

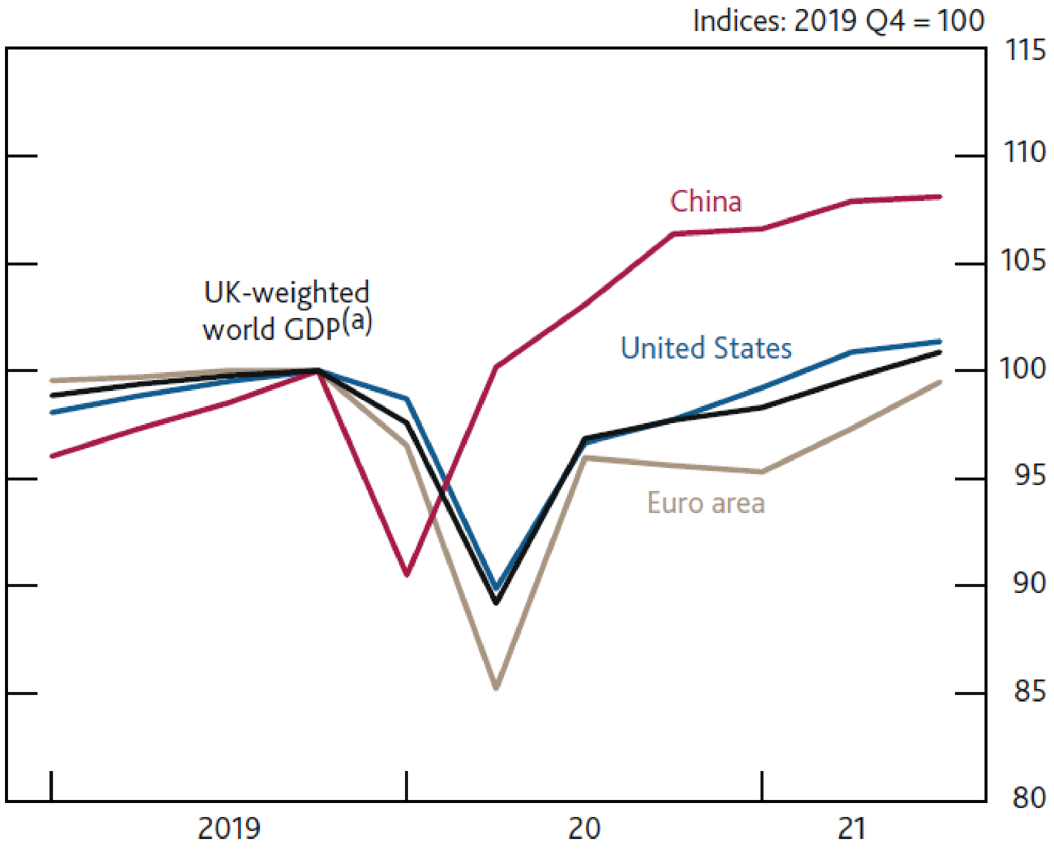


Output

Recovery continues, but has proved weaker than expected

Global recovery continuing, but a little slower

GDP in selected countries and regions

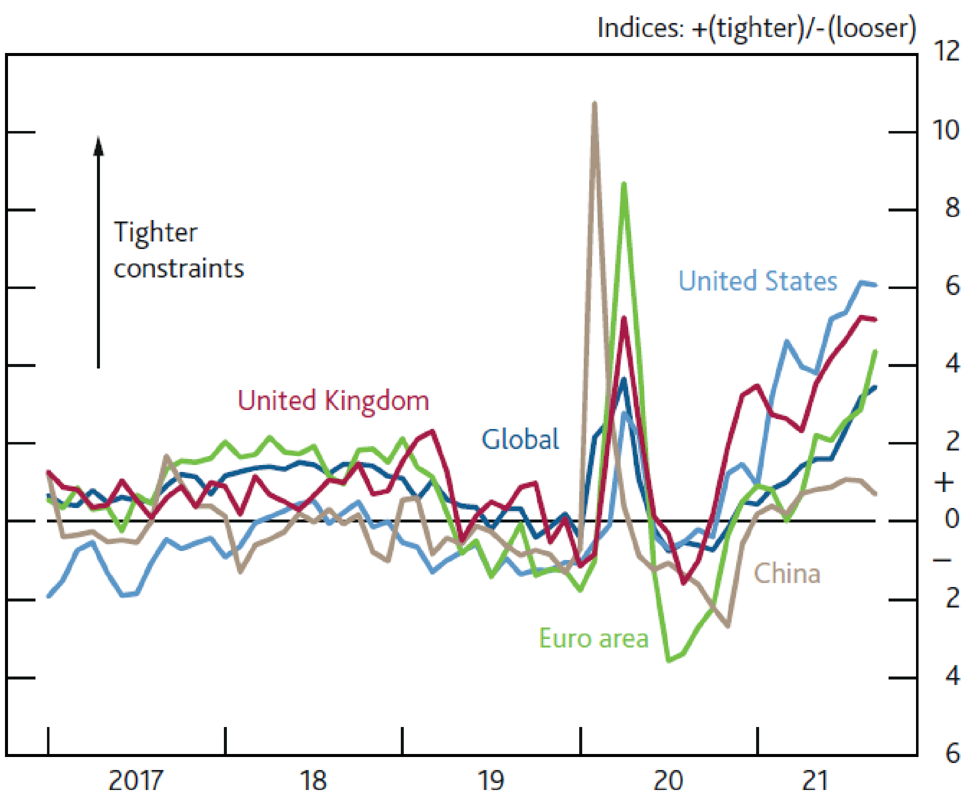


- World growth likely to be a little lower than expected in Q3 and Q4, but goods demand continues to be strong, given stimulus, esp in US, and mix of consumer spending
- As pandemic eases, demand will rotate back to services, and growth will slow to more normal rates

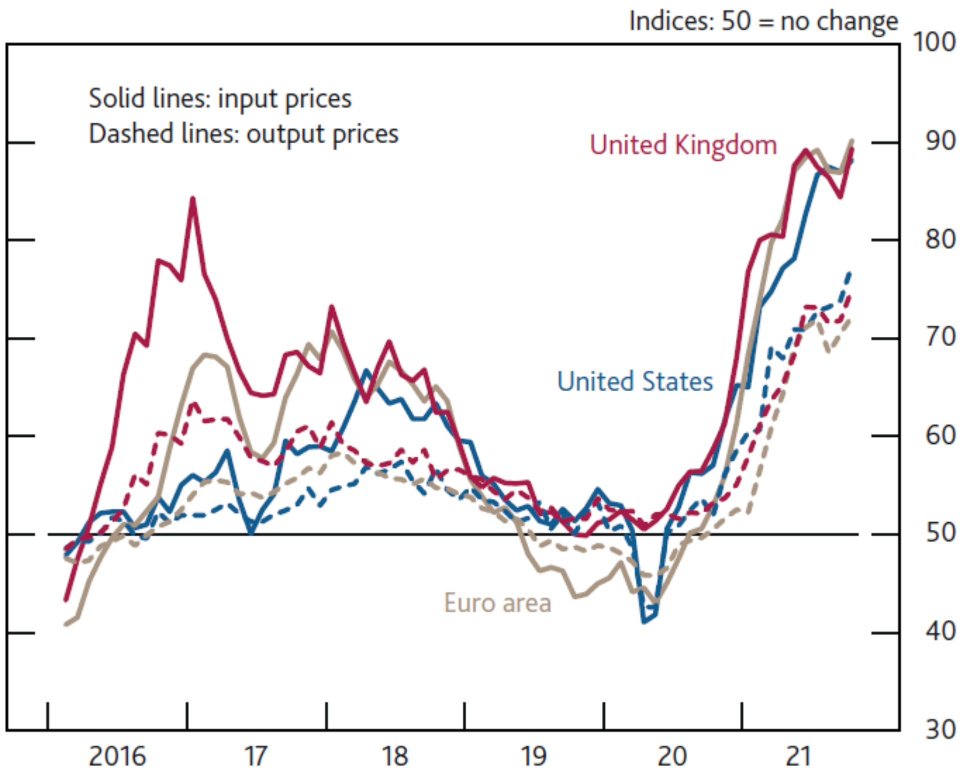
	Averages			Projections			
	1998–2007	2010–19	2020	2021	2022	2023	2024
World GDP (UK-weighted)[c]	**3**	**2¼**	**-4¼**	**5 (5)**	**3¾ (4¼)**	**3 (2¾)**	**2¼**
World GDP (PPP-weighted)[d]	4	3¾	-3¼	5½ (6)	4½ (4¾)	4¼ (4)	3½
Euro-area GDP[e]	2¼	1½	-6½	5 (4½)	3¾ (5)	2¼ (2¼)	1½
US GDP[f]	3	2¼	-3½	5½ (6½)	4¾ (5)	3 (2¼)	2
Emerging market GDP (PPP-weighted)[g]	5½	5	-2	6 (6¾)	5¼ (5)	5½ (5½)	4¾
of which, China GDP[h]	*10*	*7¾*	*2½*	*7¾ (8½)*	*5 (5½)*	*5¾ (5½)*	*5½*

Supply constraints weighing on growth, while bottlenecks drive higher prices

Indicators of supply constraints[a]



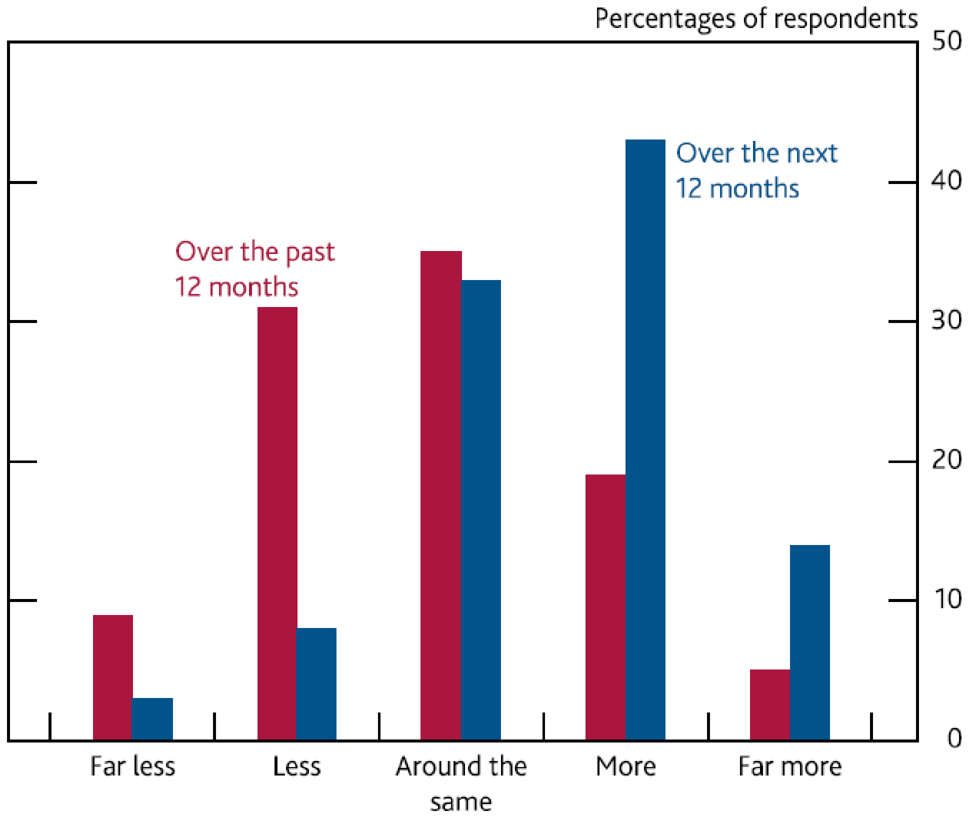
Survey indicators of manufacturers' input and output prices[a]



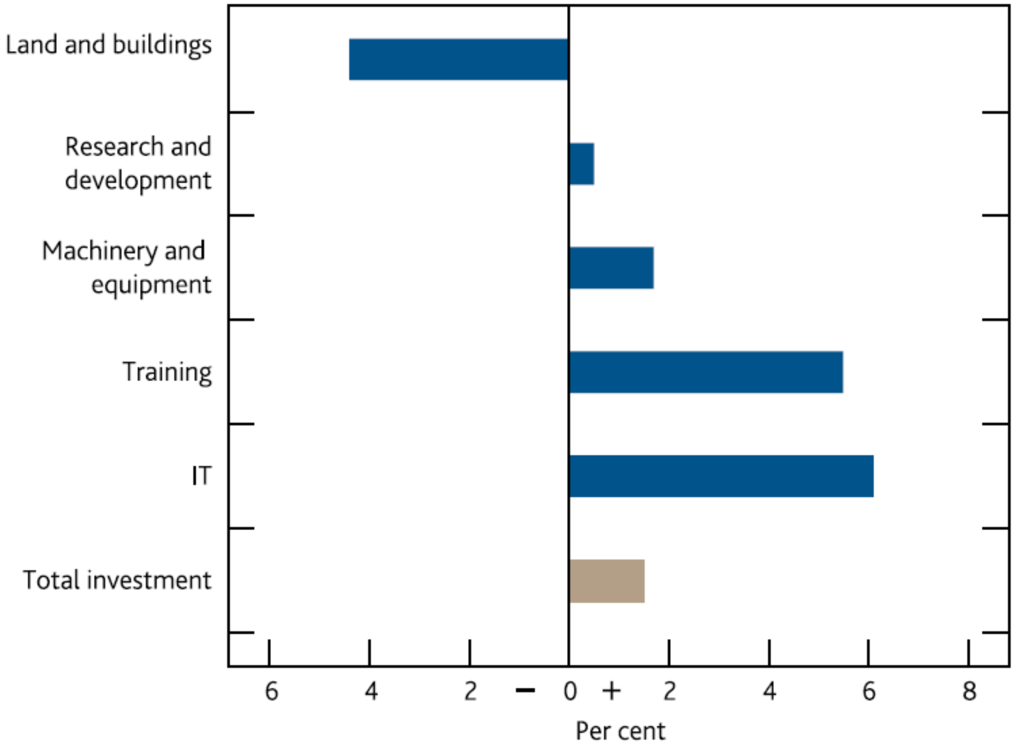
- Strong goods demand is running up against Covid-related supply constraints, pushing up input and output prices globally. Easing of the pandemic and rotation of demand will allow these to work through, but may not be fully resolved until the end of next year.

Businesses are optimistic on investment, particularly IT and training

Bank's Agents' survey[a]



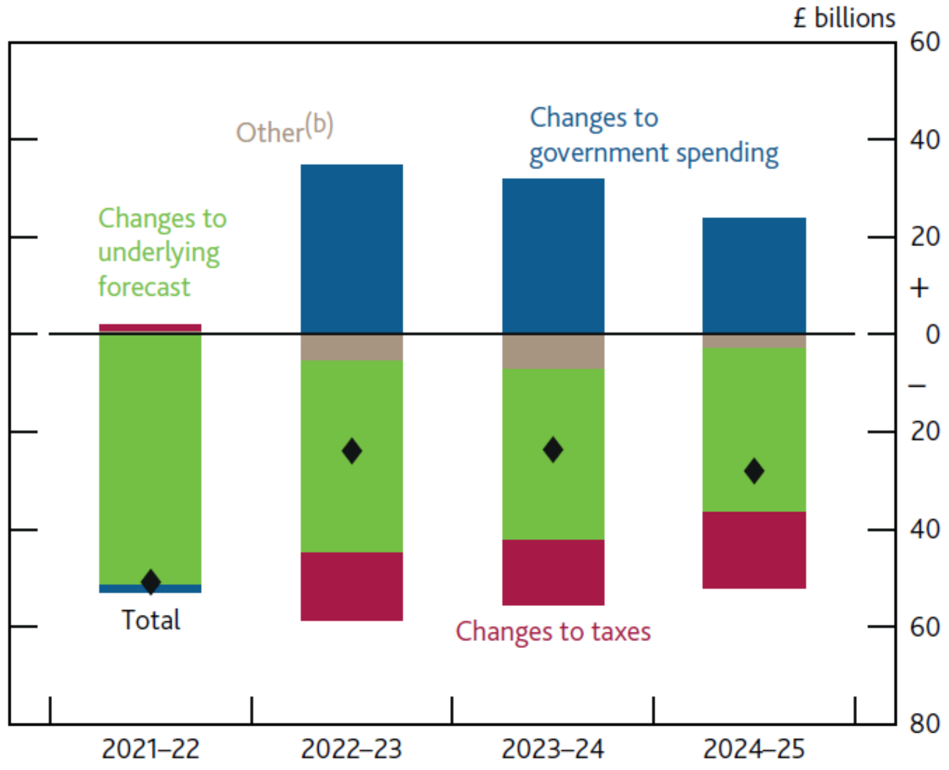
Firms' expectations for the impact of Covid on investment from 2022 onwards[a]



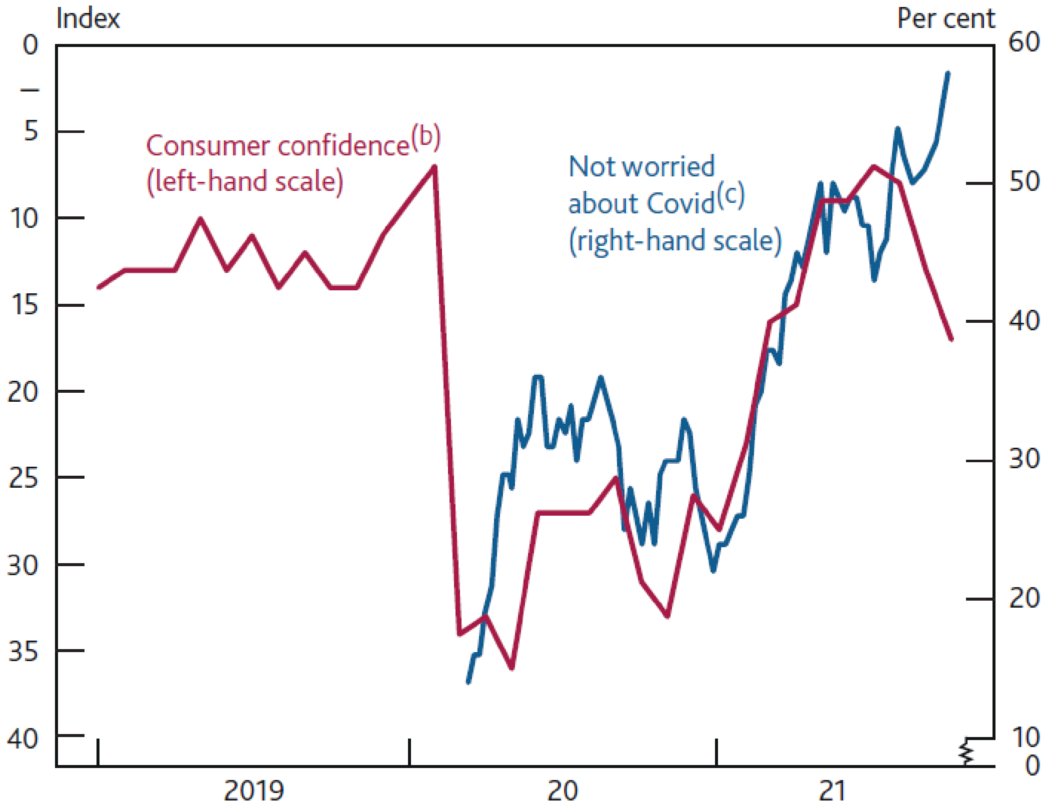
- Businesses themselves are optimistic about future investment – albeit from a very low base
- Prioritising training and IT over land and buildings

Further near-term fiscal support ahead of later tightening, risks to consumer confidence

Changes to the OBR forecast for public sector net borrowing since March 2021[a]



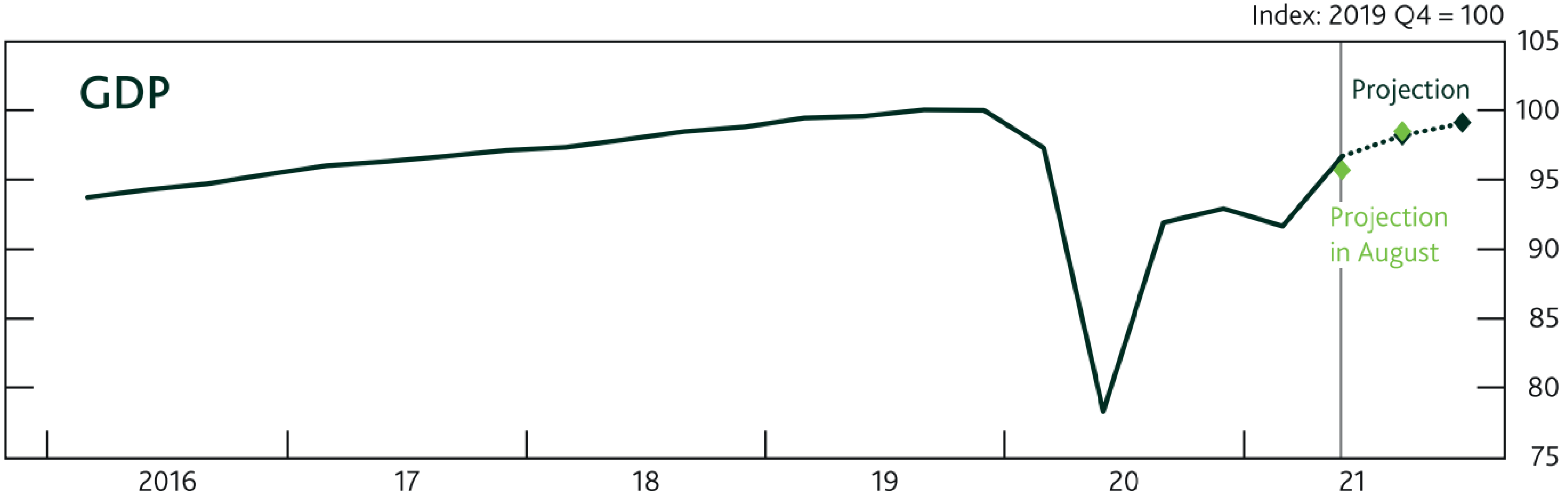
Consumer confidence and worries about Covid[a]



- Budget saw further increases in government spending, front-end loaded.
- Consumer confidence showing some fragility, perhaps stemming from cost-of-living rises

The economy is getting close to where it was before the pandemic

Near-term projections[(a)]

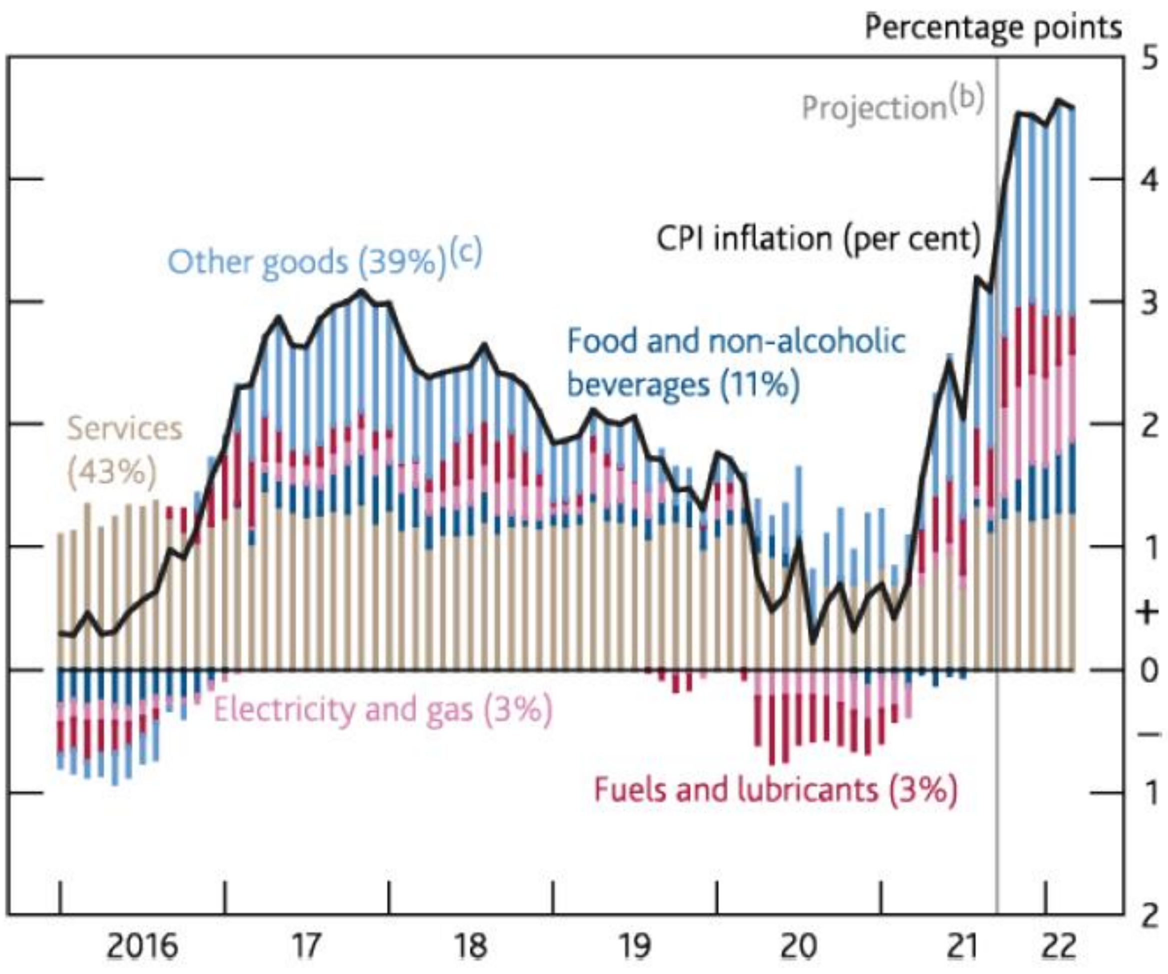


Prices

Inflation set to rise further owing to energy and goods price increases, before returning to target

Goods prices and energy pushing inflation up to 4½%

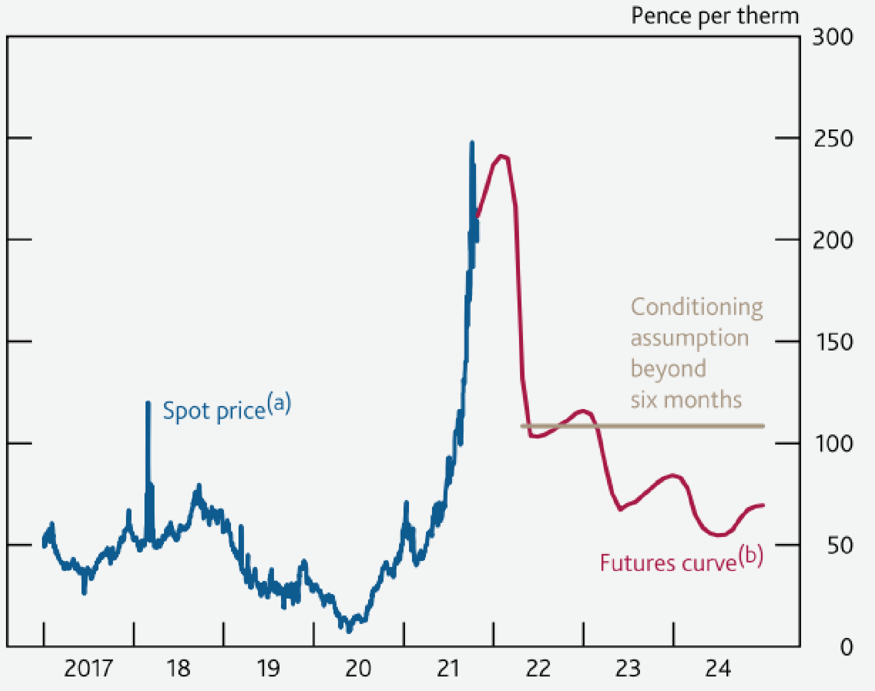
Contributions to CPI inflation[a]



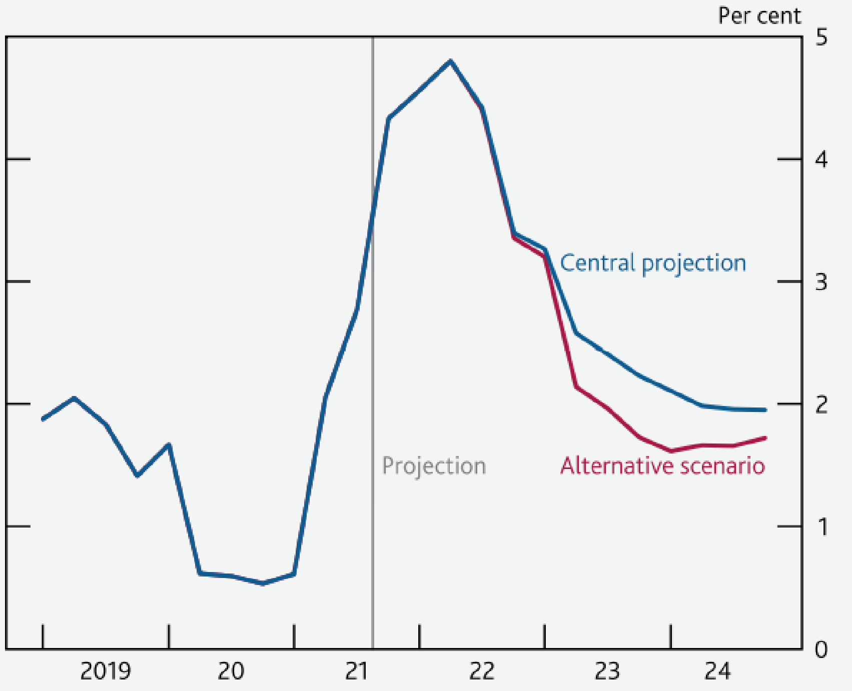
- Wholesale gas prices have risen by 130% since the summer and, alongside goods price rises, mean inflation likely to reach 4½% by November and stay close to that rate through Q1
- If gas futures prices stick, further rise in Ofgem cap in April could see inflation reach 5%

Outlook for energy prices very uncertain

Wholesale gas spot prices, futures prices and the conditioning assumption underlying the MPC's central projections



CPI inflation in the MPC's central projection and alternative scenario

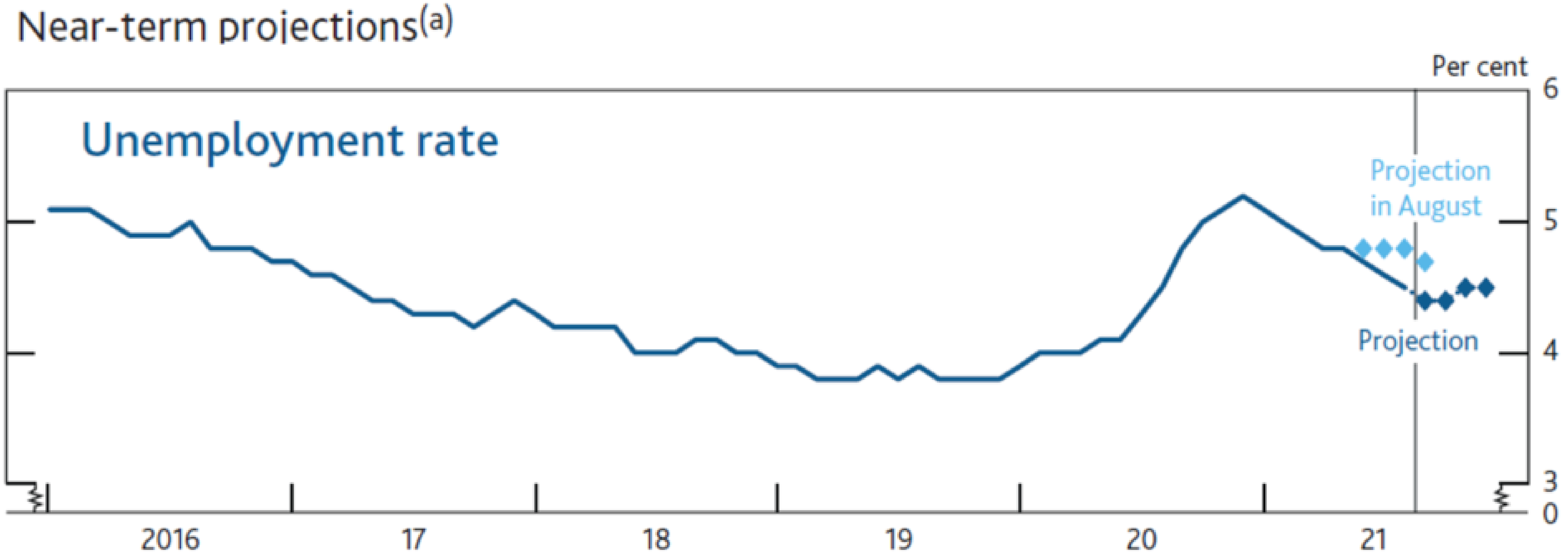


- Wholesale gas prices, like all commodity prices, inherently difficult to predict. MPC convention is to assume a random walk from 6 months onwards, but futures curves are currently steeply downward sloping.
- The difference the choice of conditioning assumption makes to inflation illustrates the uncertainty here.

Labour market

Unemployment has proved lower than expected; key issue is whether labour market tightness leads to sustained underlying wage growth

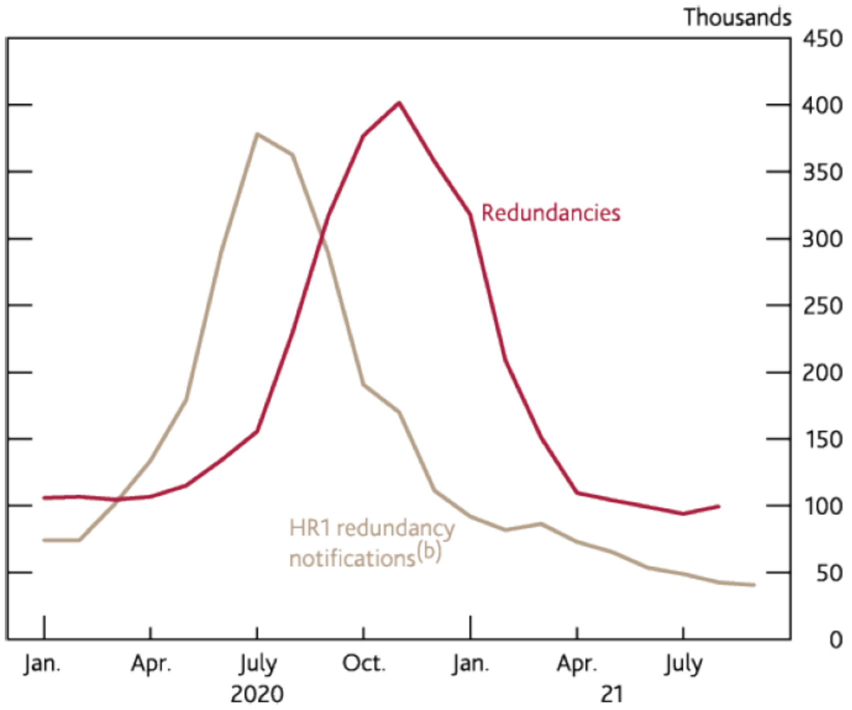
Unemployment data has been lower than expected



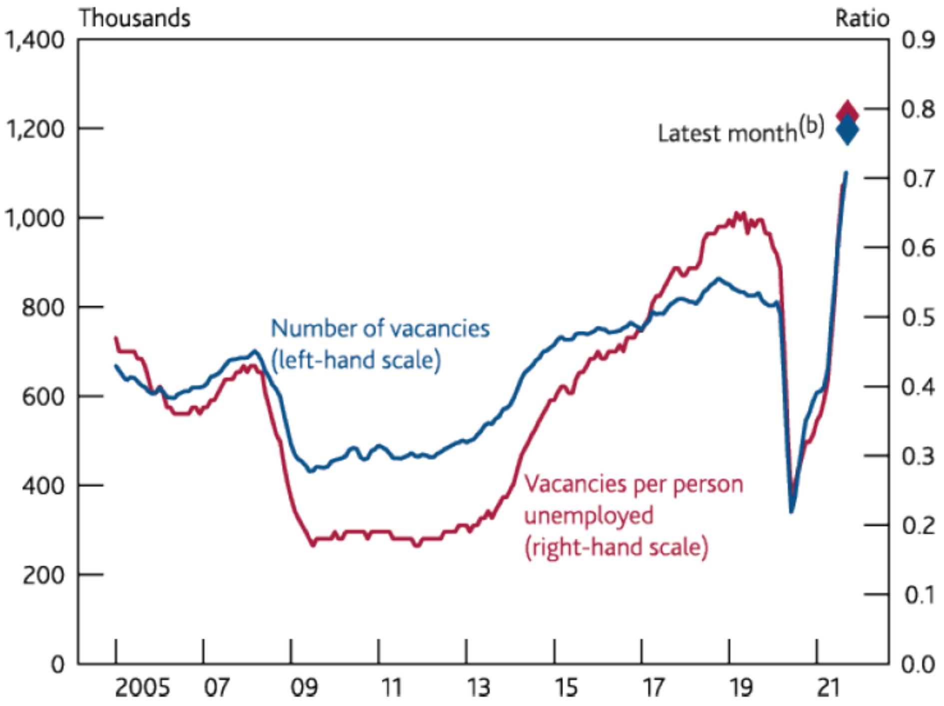
- Unemployment has continued to decline, and more rapidly than expected. Only a small increase projected post-furlough, to 4.5%, but still uncertainty around that.
- Level of unemployment still higher than pre-Covid, as is labour market inactivity

Few signs of a pick-up in redundancies as furlough ended, vacancies continue to rise

Redundancies and HR1 redundancy notifications[a]



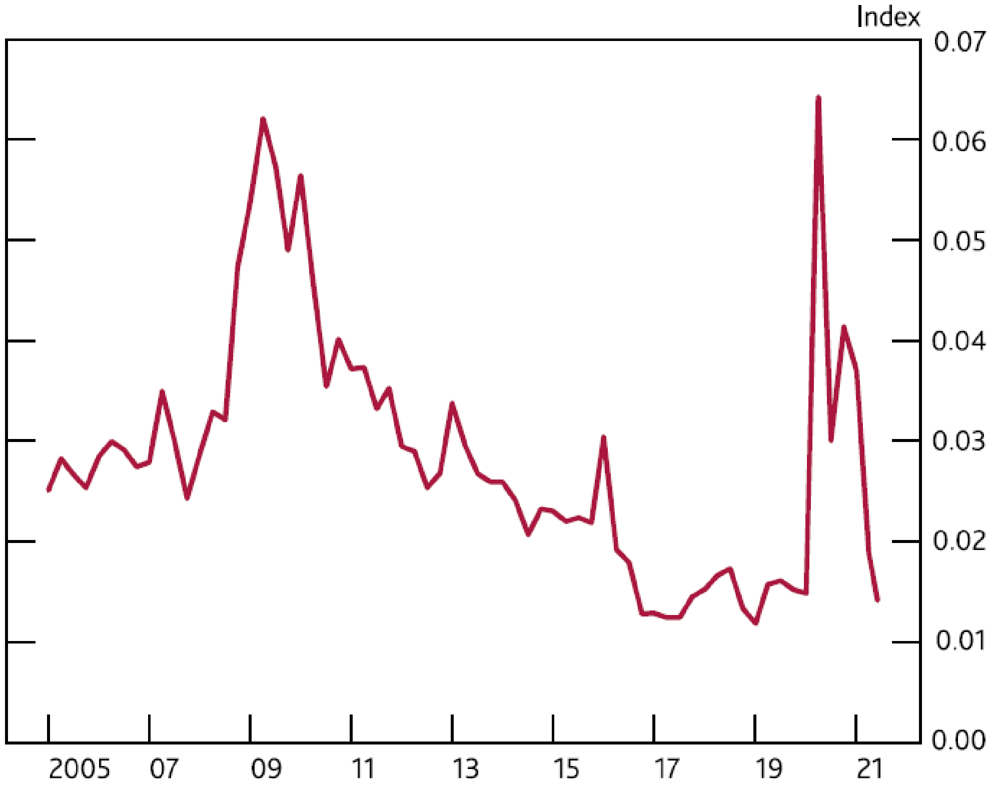
Vacancies[a]



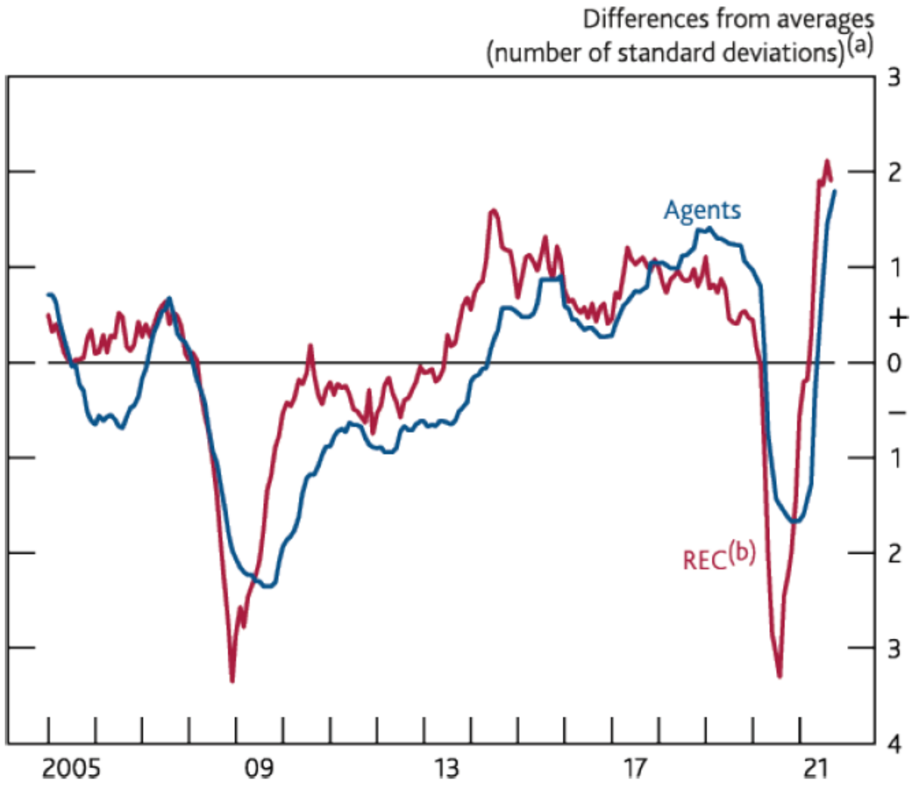
- Neither HR1 redundancy notifications (for companies with >20 employees) nor the ONS BICS survey have show any material increase as the furlough scheme has come to an end
- Vacancies continue to increase strongly, suggesting robust labour demand and further tightening in the labour market

Mismatch may be fading, but recruitment difficulties intensifying

Sectoral mismatch index[(a)]



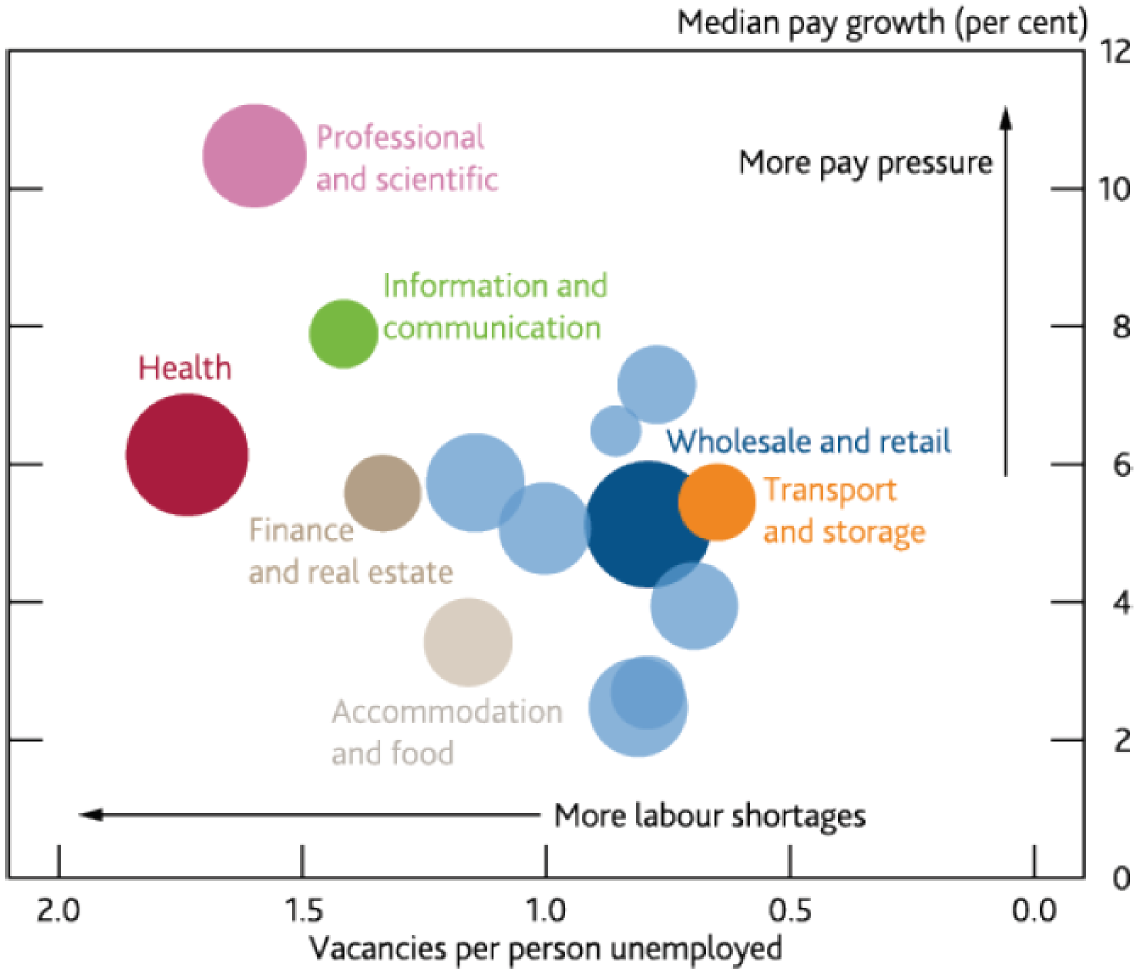
Indicators of recruitment difficulties



- As the economy has re-opened, mismatch between job-seekers and vacancies seems to have faded, but indicators of recruitment difficulties have nonetheless intensified further

Vacancies vary by sector and are correlated with wage growth

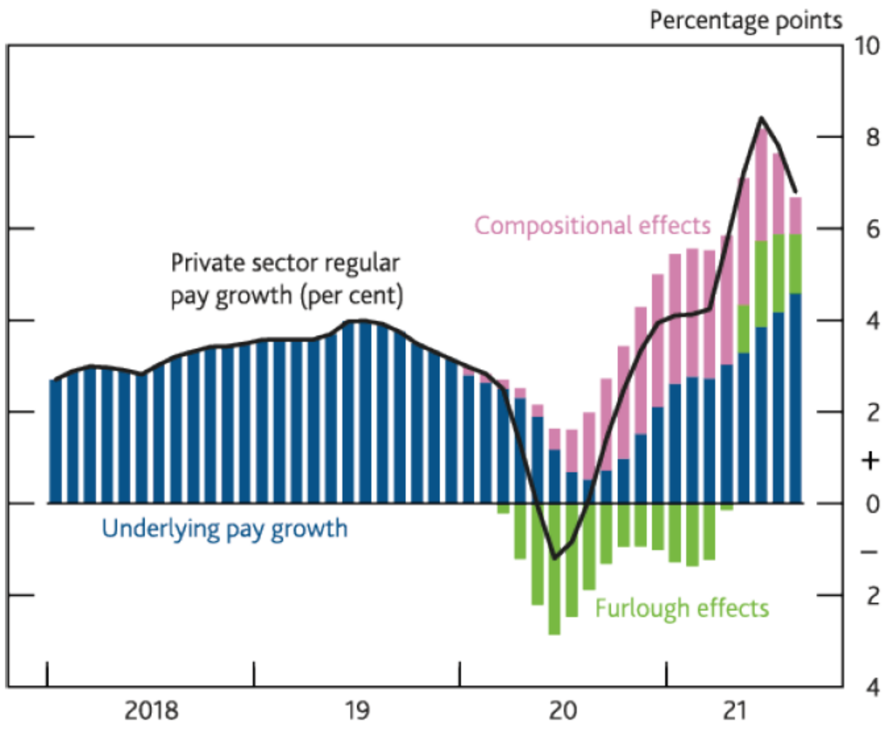
Ratio of vacancies per person unemployed and annual pay growth[(a)]



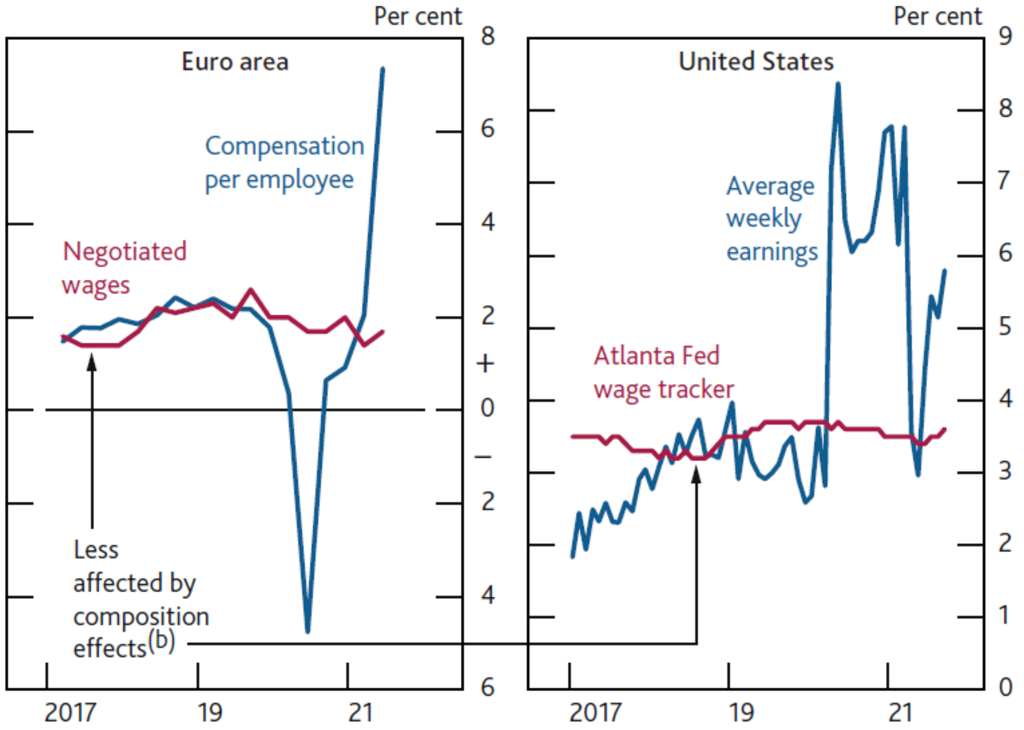
- Those sectors with the most vacancies are generally seeing more pay pressure
- Alongside remaining mismatch, higher inactivity, less migration and greater demand from the public sector may all have been factors

Underlying pay growth in the UK more clearly above pre-Covid rates than in US or euro area

Contributions to annual growth in private sector regular pay[a]



Selected measures of euro-area and US annual wage growth[a]



- Looking through compositional and furlough effects, underlying pay growth continues to rise and is above pre-Covid rates – unlike in the US or euro area
- Some of this may be erratic and ease as labour market functioning continues to improve – MPC expects pay growth to slow in 2022

MPC perspectives and policy

Inflation outlook on market and constant rates

Chart 1.4: CPI inflation projection based on market interest rate expectations, other policy measures as announced

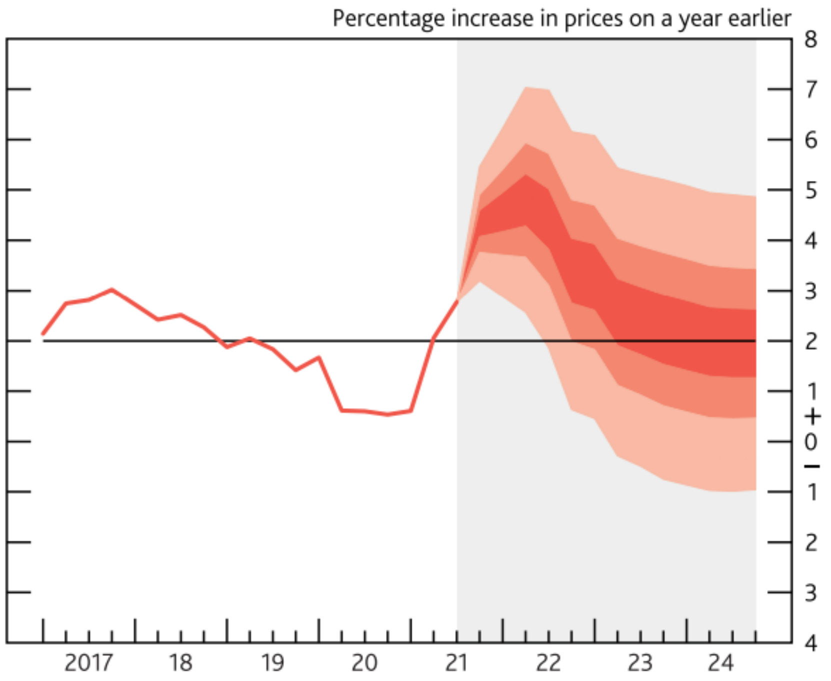
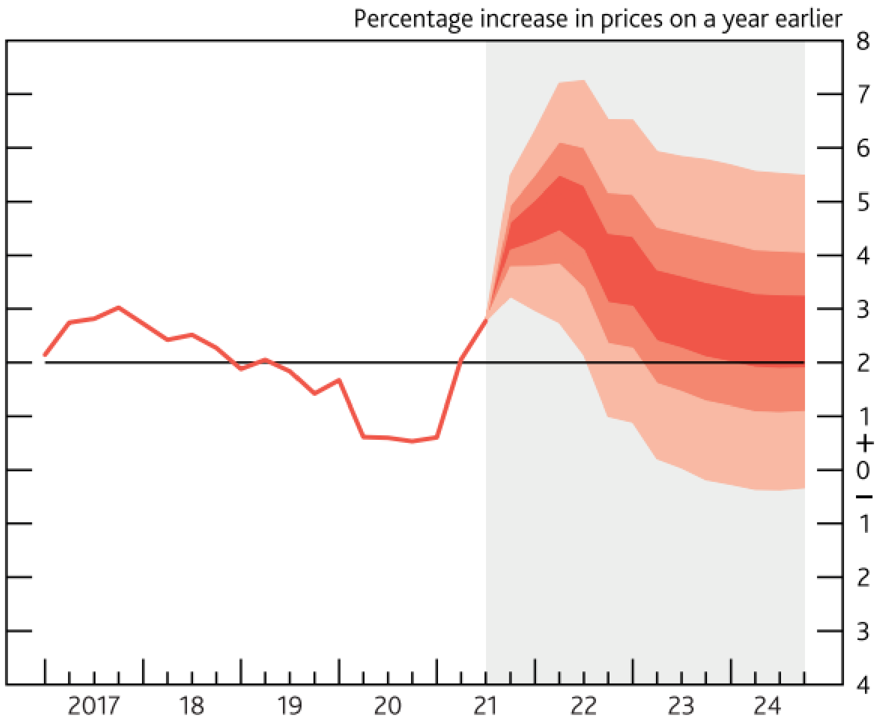


Chart 1.6: CPI inflation projection based on constant interest rates at 0.1%, other policy measures as announced



- At the market curve, inflation is slightly below target at the end of the forecast.
- If rates were not to move at all, then inflation would be above target, even in our alternative energy price scenarios
- Indicative of the broad direction of travel for rates

MPC perspectives and policy

- Majority of MPC members judge that stance remains appropriate at this meeting. Near-term uncertainties, especially around labour market following end of furlough.
- If incoming data, particularly on labour market, are broadly in line with MPR projections, it will be necessary over coming months to increase Bank Rate to return CPI inflation sustainably to 2%.
- On the market-implied path for Bank Rate, CPI inflation is below 2% at end of forecast period, and would probably fall a little further given that spare capacity is expected to emerge in third year of forecast.
- Significant uncertainty around the forward path for energy prices. In an alternative scenario conditioned on full forward curves, CPI inflation is materially lower than the central projection over second half of forecast (though demand is also stronger).

Q&A