BANK OF ENGLAND

# February 2022

# *Monetary Policy Report*

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Friday 4 February 2022

# Plan for the session

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

# Quick tour of the Report

Headlines

# Report in a nutshell

The UK economy continues to recover

Higher energy and goods prices are pushing inflation above our 2% target

We expect inflation to rise to around 7% in the spring, but then fall back

We have increased interest rates to return inflation to our 2% target

# Forecast summary table

| | Projections | | | |
|---|---|---|---|---|
| | 2022 Q1 | 2023 Q1 | 2024 Q1 | 2025 Q1 |
| GDP[c] | 7.8 (9.5) | 1.8 (2.1) | 1.1 (1.0) | 0.9 |
| CPI inflation[d] | 5.7 (4.6) | 5.2 (3.3) | 2.1 (2.1) | 1.6 |
| LFS unemployment rate | 3.8 (4.2) | 4.2 (4.0) | 4.6 (4.2) | 5.0 |
| Excess supply/Excess demand[e] | +½ (+½) | -¼ (+¼) | -½ (0) | -1 |
| Bank Rate[f] | 0.4 (0.5) | 1.3 (1.0) | 1.4 (1.0) | 1.3 |

- Growth weaker throughout, as higher costs, especially energy, depress aggregate income
- Higher near-term path for inflation, below target by the end
- Excess demand initially, but moves into excess supply which builds over the forecast – also reflected in unemployment
- All dependent on a path for Bank Rate that rises quickly to 1.4%

# Output

# Global recovery continued despite rising Covid cases

GDP in selected countries and regions

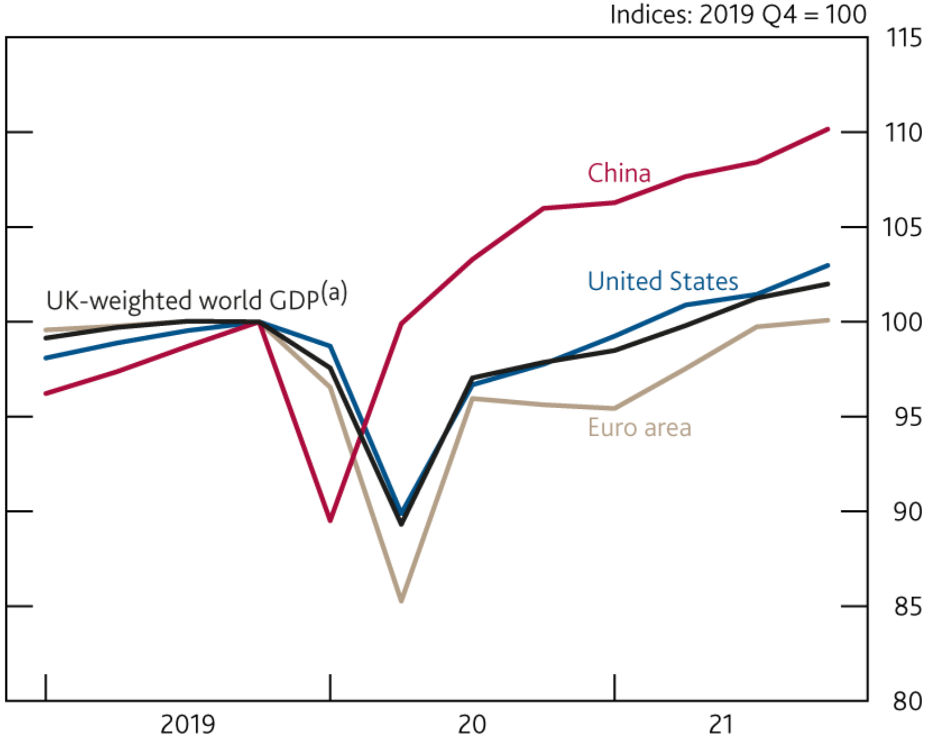
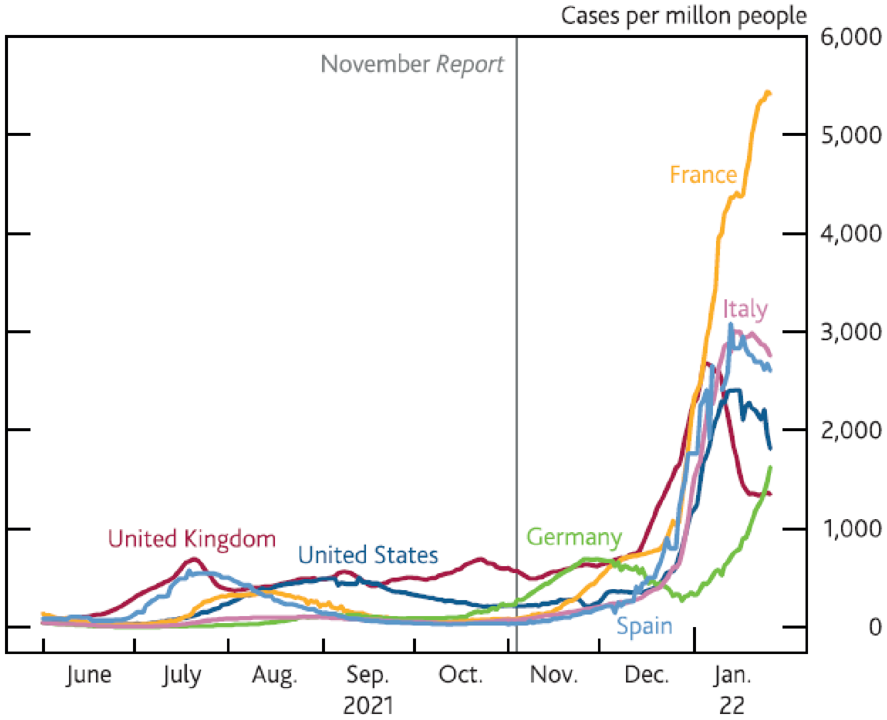



**Chart 2.3:** ...despite rising Covid cases

Daily new confirmed Covid-19 cases(a)

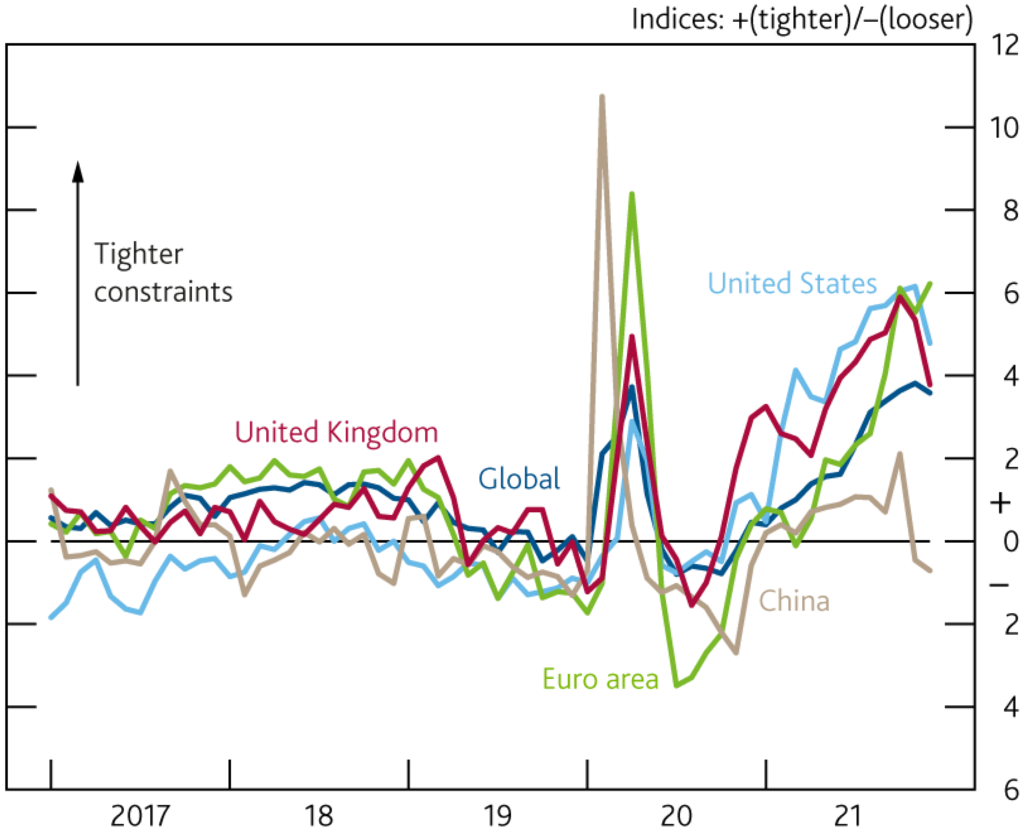



Sources: COVID-19 Data Repository by the Centre for Systems Science and Engineering at John Hopkins University, Our World in Data and Bank calculations.

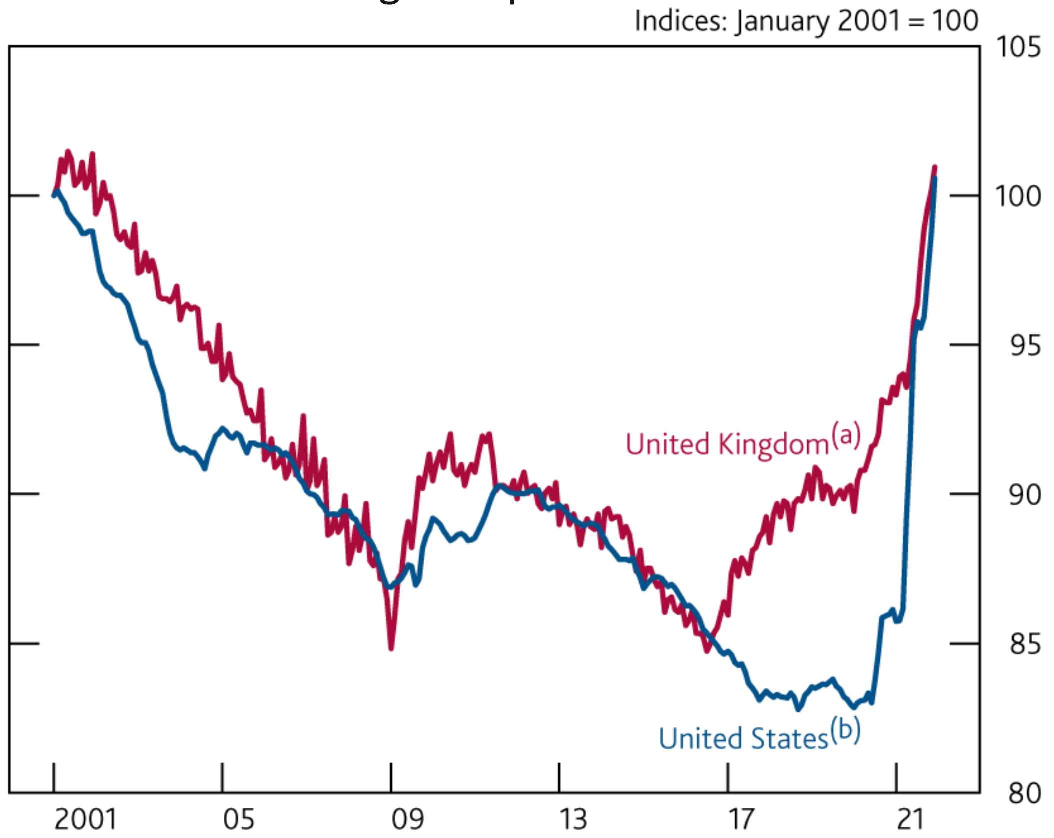
- Global GDP is back above its pre-Covid peak and goods demand in advanced economies continues to robust, particularly in the US
- Some signs of rotation back to services in the latest data

# Global bottlenecks possibly peaking, but continue to push up prices

Indicators of supply constraints




UK and US durable goods price indices

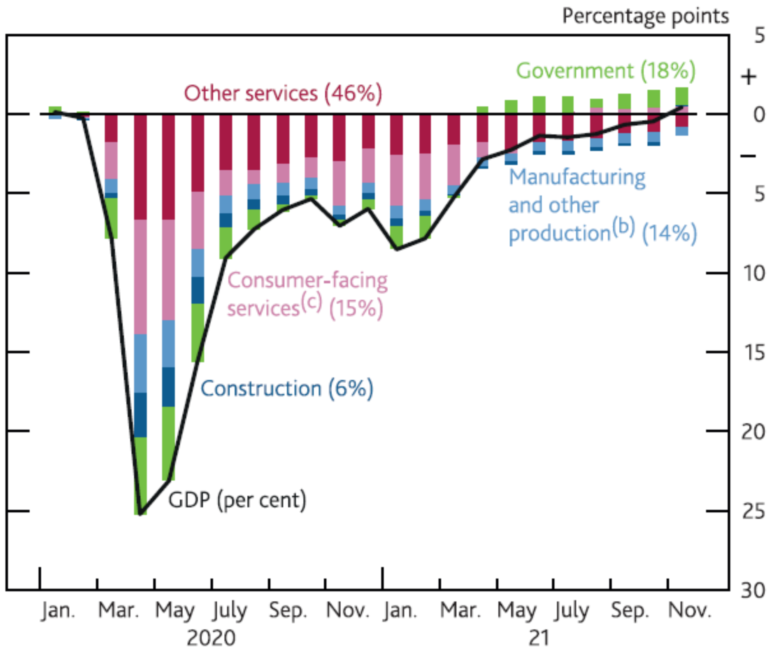



- Indicators of supply constraints may be peaking, but still be an issue of the course of this year
- Continued upward pressure on prices in the meantime, particularly for durables – will fall stop rising as demand rotates, but when and how quickly is uncertain

# UK output slowed temporarily by Omicron

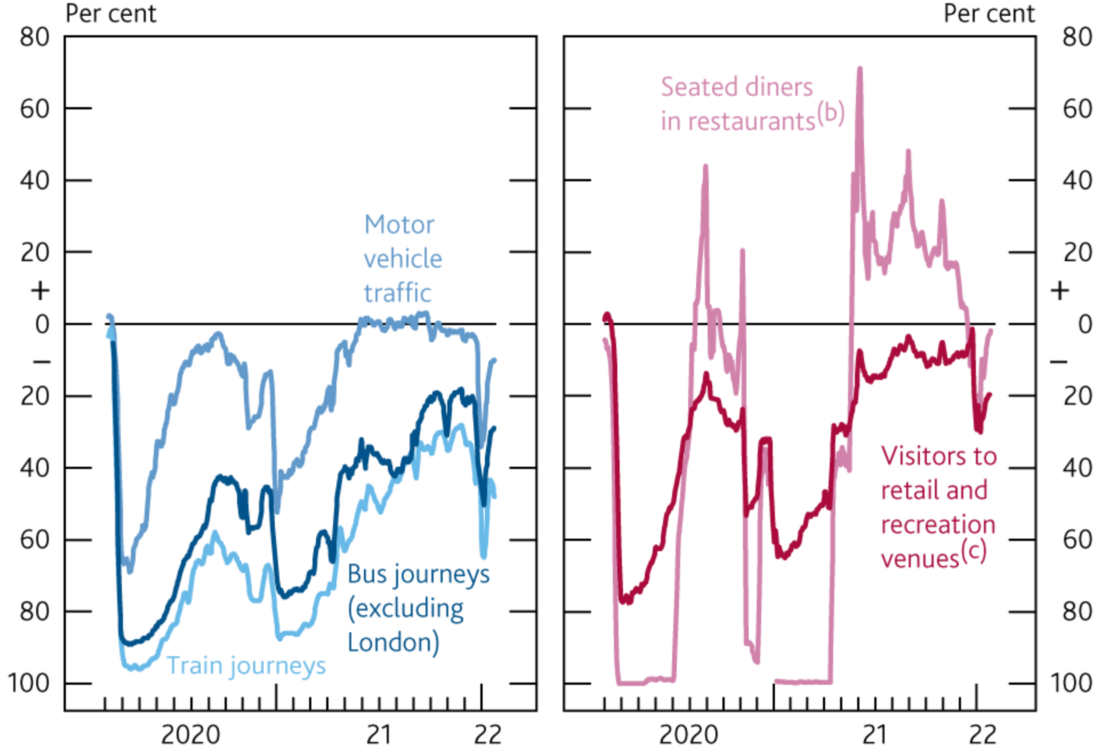
**Chart 2.7:** GDP recovered to its pre-pandemic level in November...

Contributions to change in monthly GDP since 2019 Q4[a]




Sources: ONS and Bank calculations.

High-frequency indicators of economic activity




- UK GDP has regained its pre-pandemic peak in latest data
- Omicron probably represented a pause in growth
- High-frequency indictors already showing some recovery post-Omicron.

# Some headwinds remain in the very near term

Factors affecting manufacturers' production

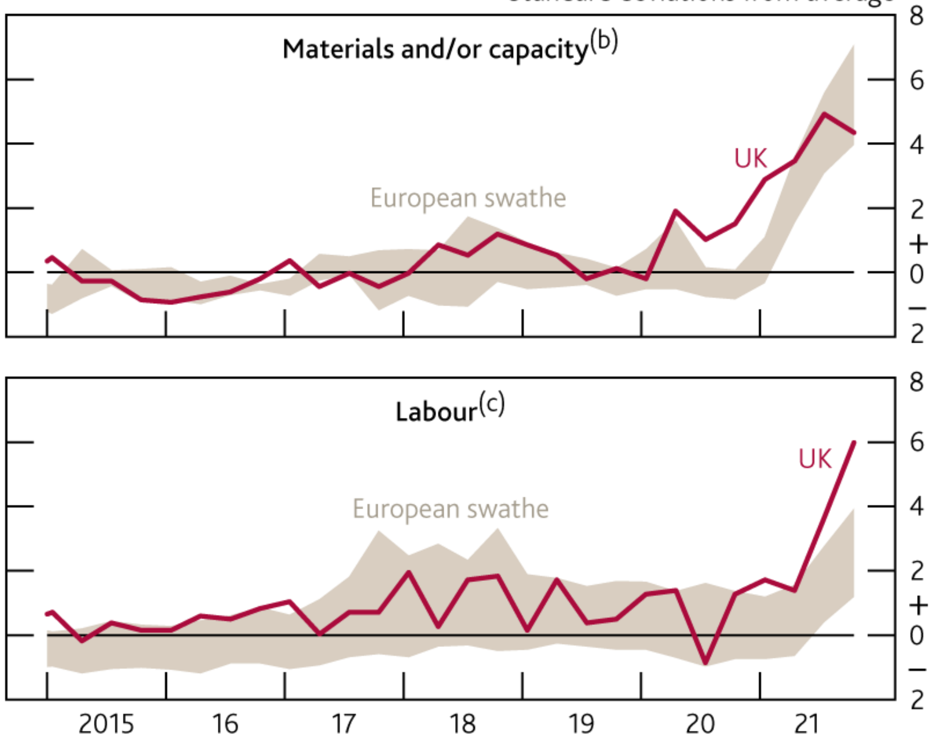
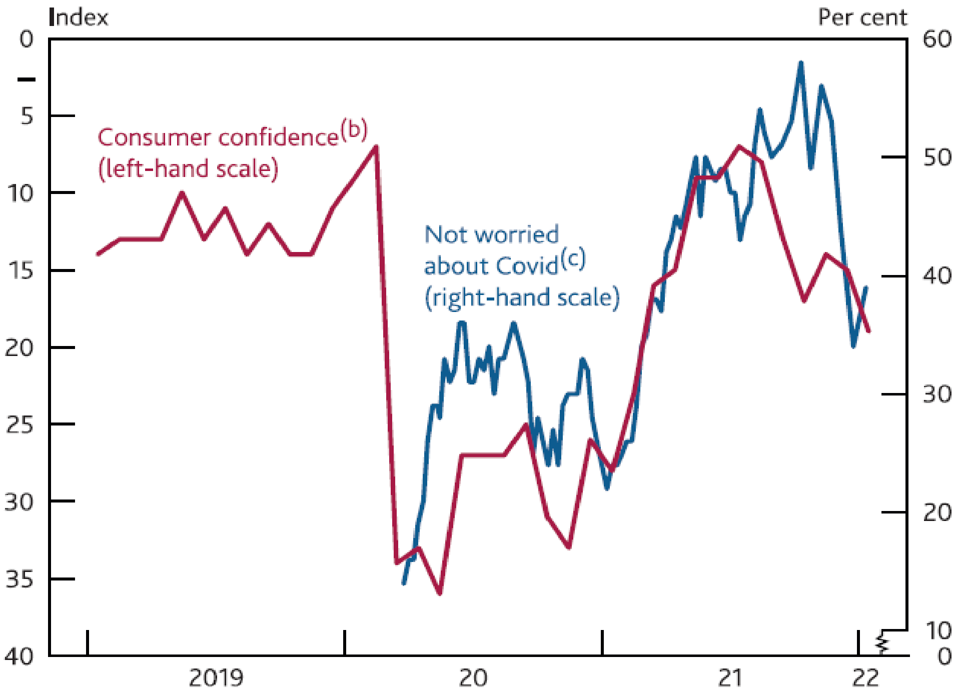



**Chart 2.10:** Consumer confidence has fallen, but is higher than earlier in the pandemic

Consumer confidence and worries about Covid[a]



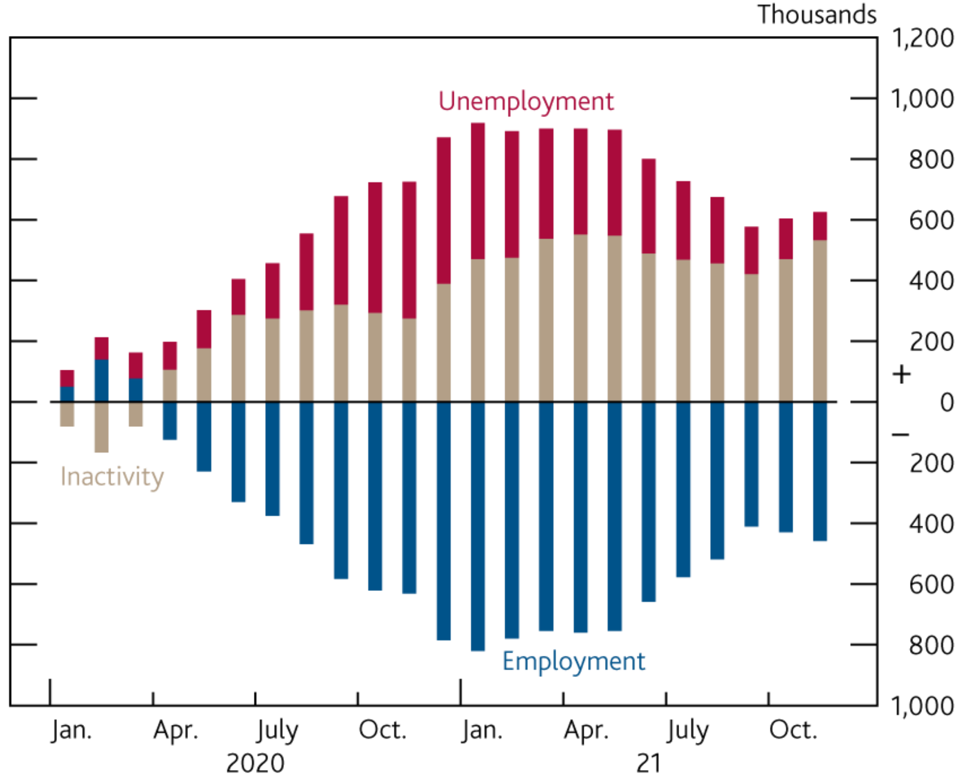

Sources: GfK, ONS, Refinitiv Eikon from LSEG and Bank calculations.

- But materials and labour shortages still material in some sectors.
- Consumer confidence also fell but remains higher than earlier in the pandemic.
- GDP growth likely to be flat across Q1 as a whole, but picking up through the quarter.

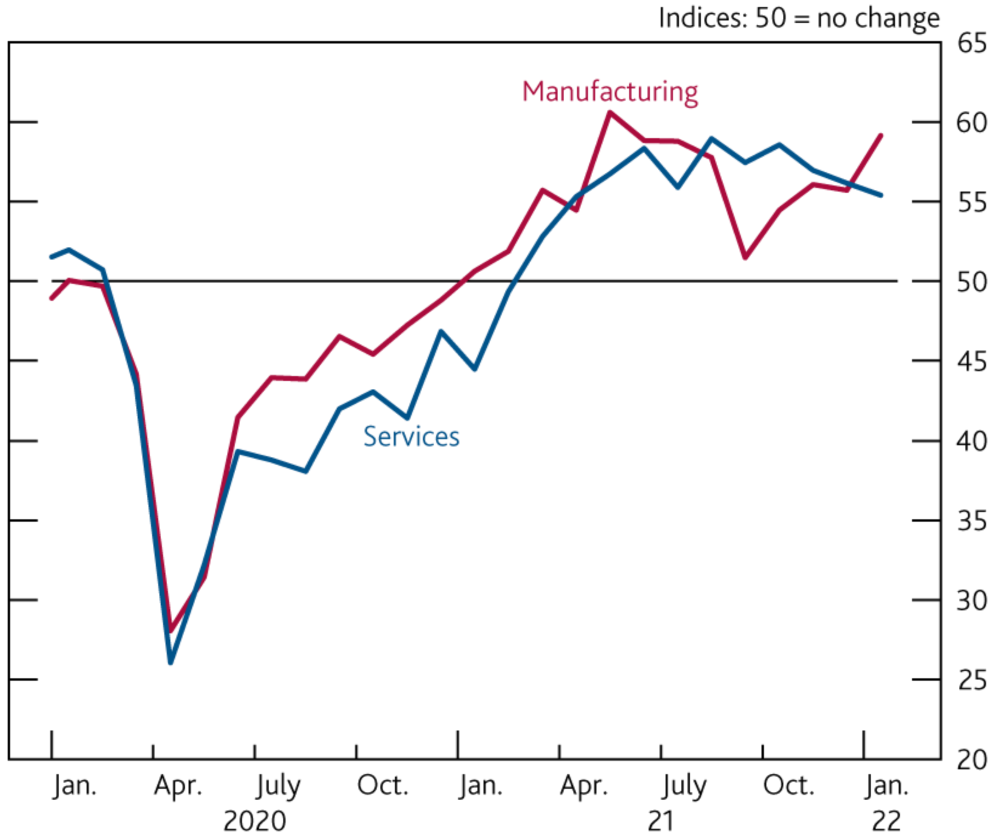
# Labour market

# Further positive surprises on unemployment

Changes in employment, unemployment and inactivity since 2019 Q4

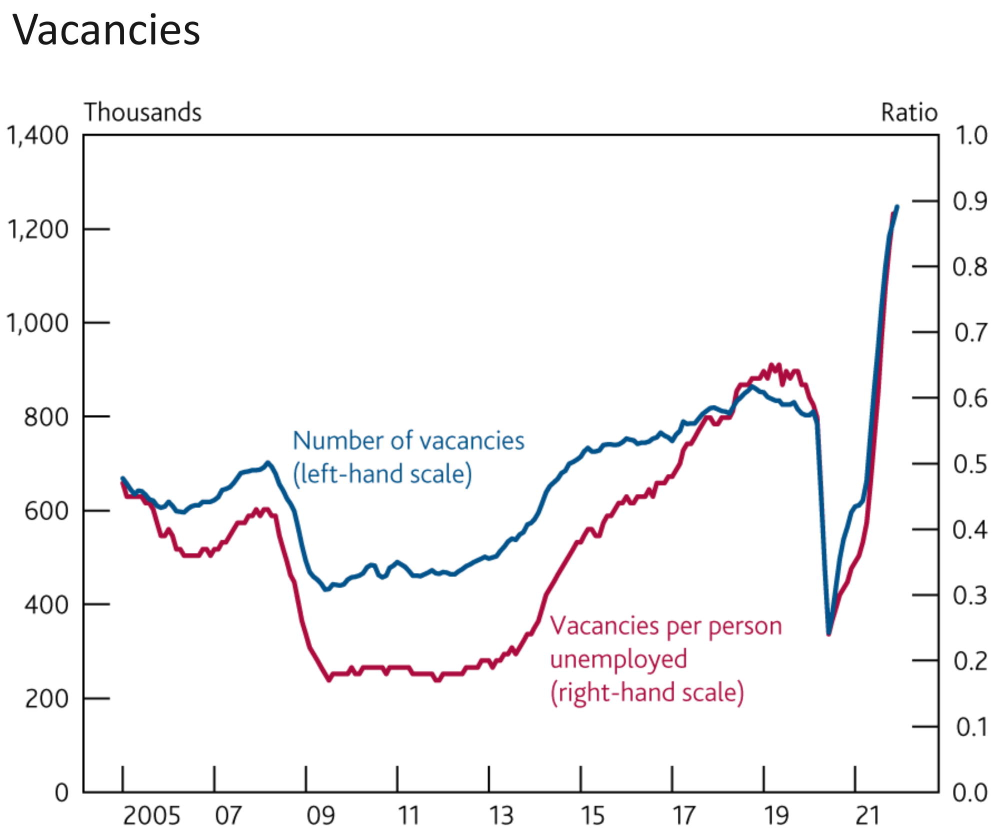


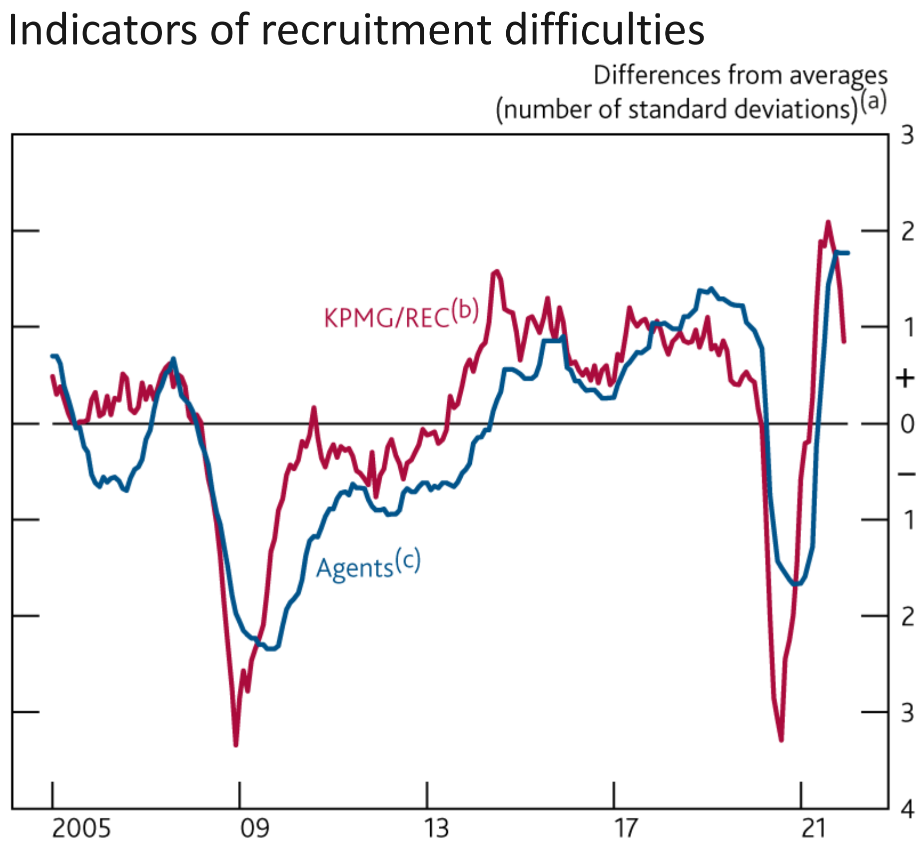

Surveys of employment growth




- Positive surprise once again on unemployment – likely to fall to 3.8% in Q1
- Employment intentions strong, but not strengthening further; inactivity notably above pre-Covid levels

# Labour market has tightened further, but likely to turn

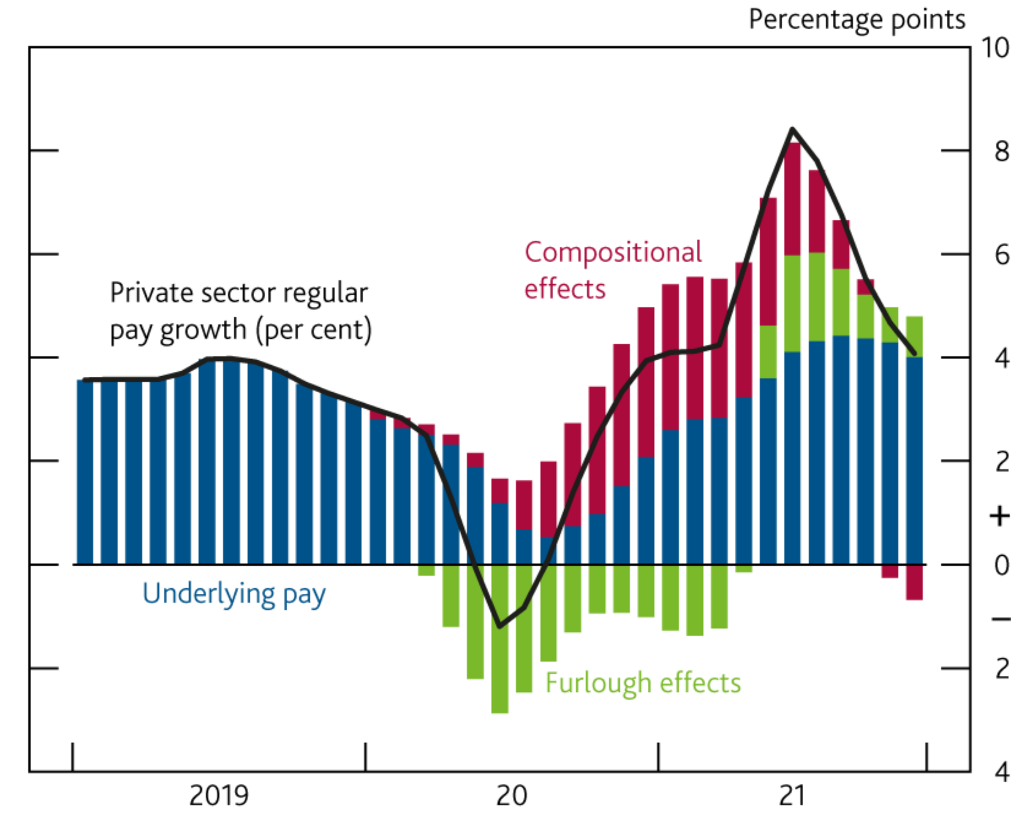



- Vacancies reached another high at year-end and recruitment difficulties still elevated
- Labour market likely to loosen over 2022 as demand slows

# Underlying wage growth stayed above pre-Covid rates

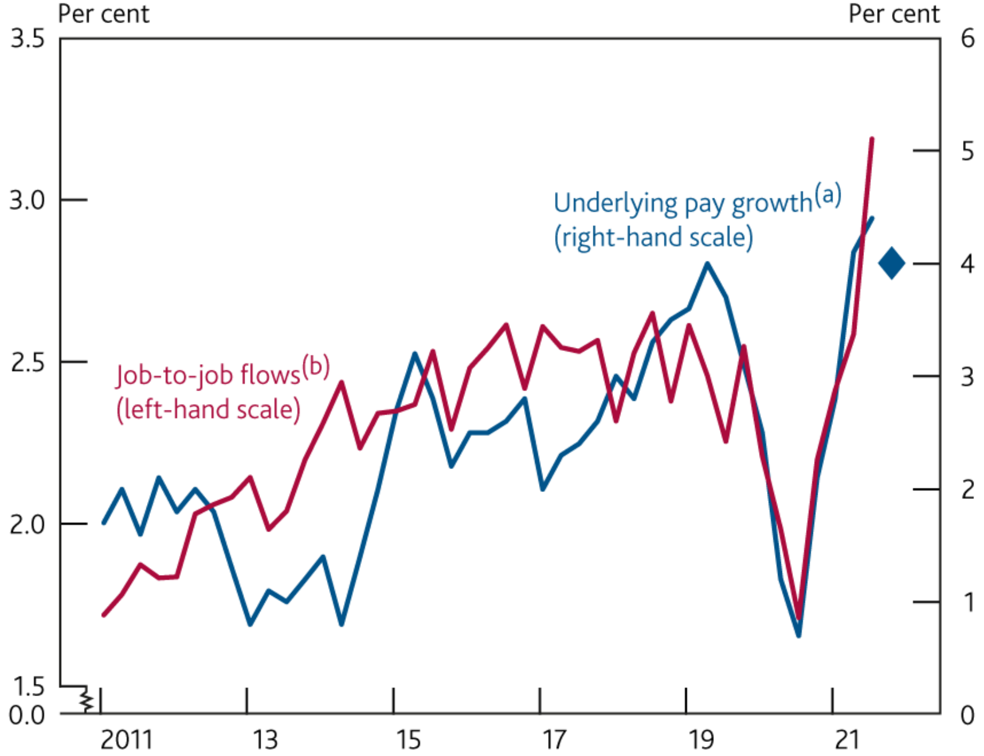
Contributions to private sector regular pay growth



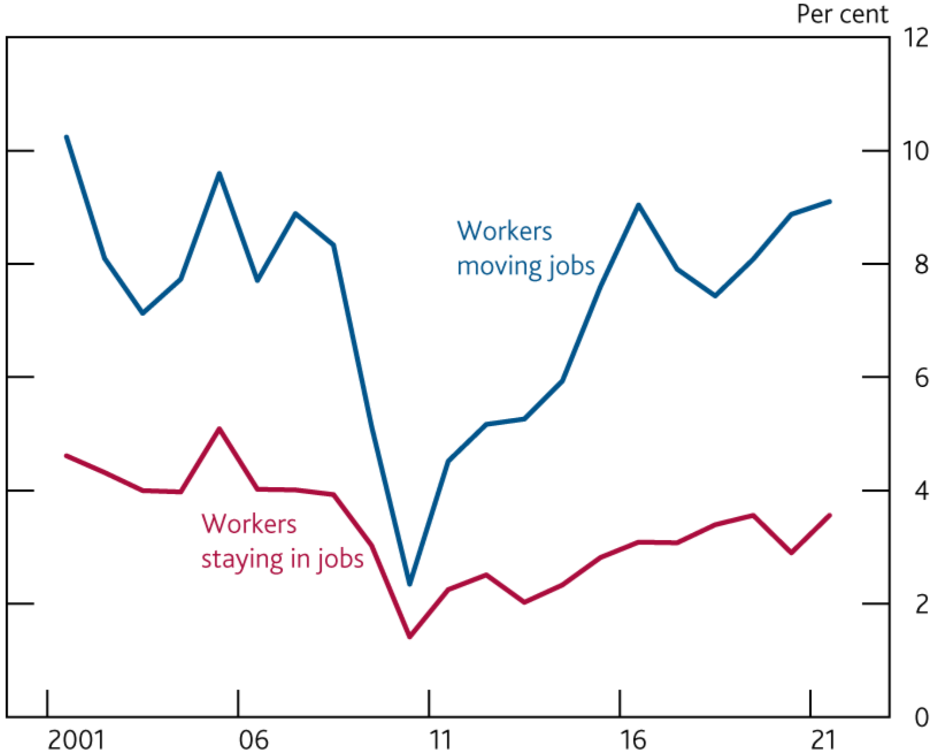

- Headline wage growth still being distorted by furlough and compositional effects
- Underlying wage growth running at 4 to 4½% , reflecting tight labour market and rising inflation

# High rates of job churn may be adding impetus to pay

Job-to-job flow rate and underlying private sector annual pay growth



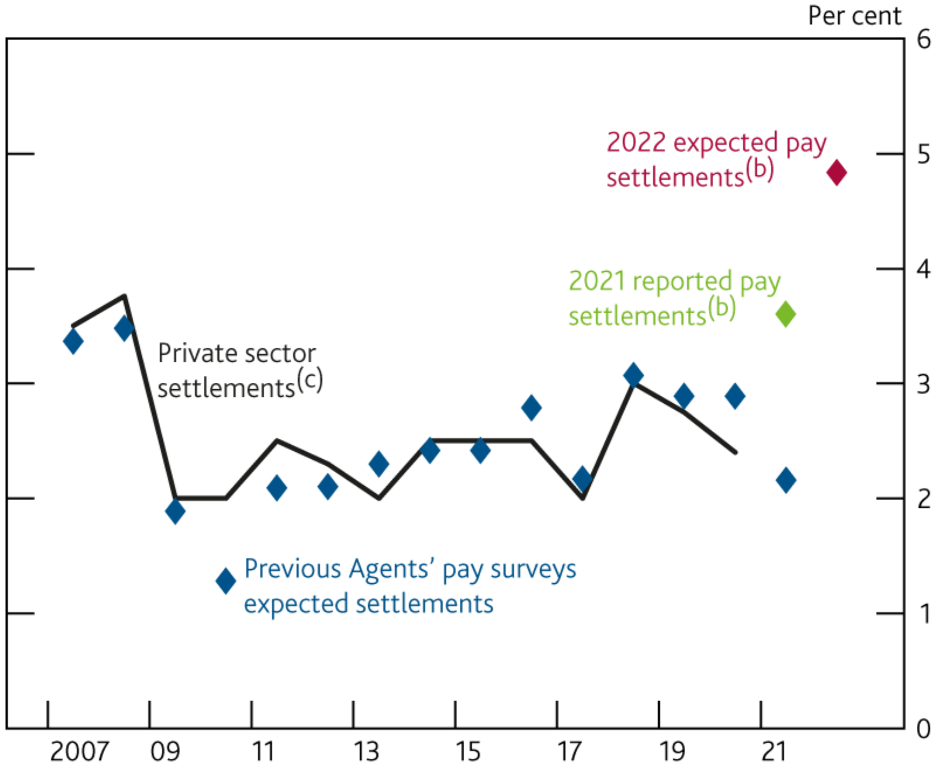

Median annual growth rates of pay



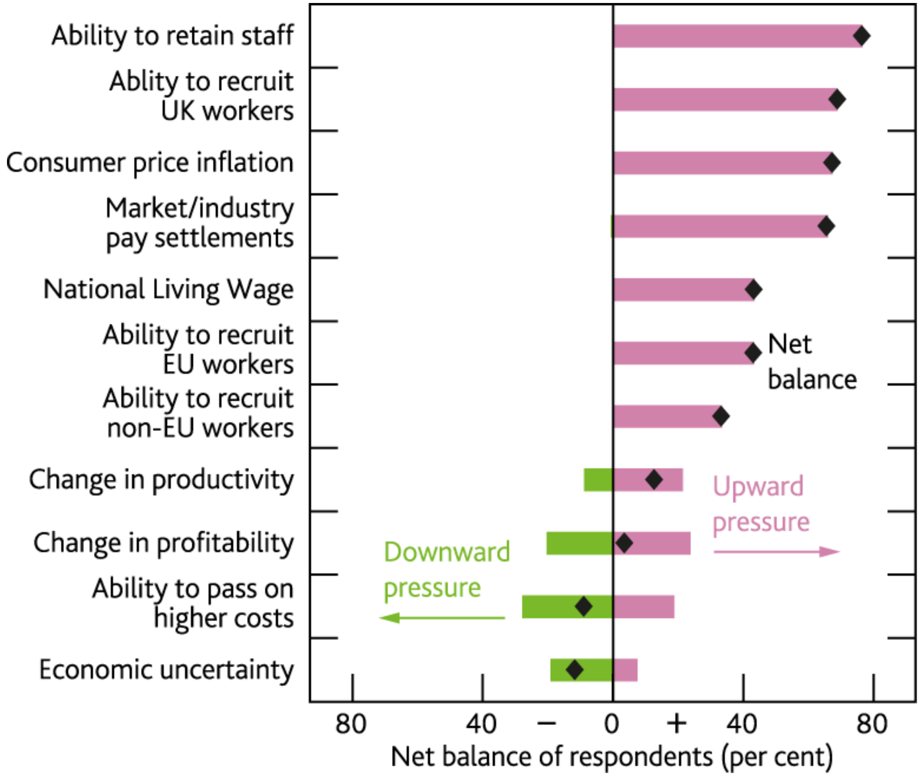

- Rising pay growth has gone hand-in-hand with very strong job-to-job flows
- Pay growth tends to be much higher for those who change jobs
- May be as much a reflection of tight market as additional to it

# Agents’ pay survey suggest step up in 2022 settlements

Pay settlements



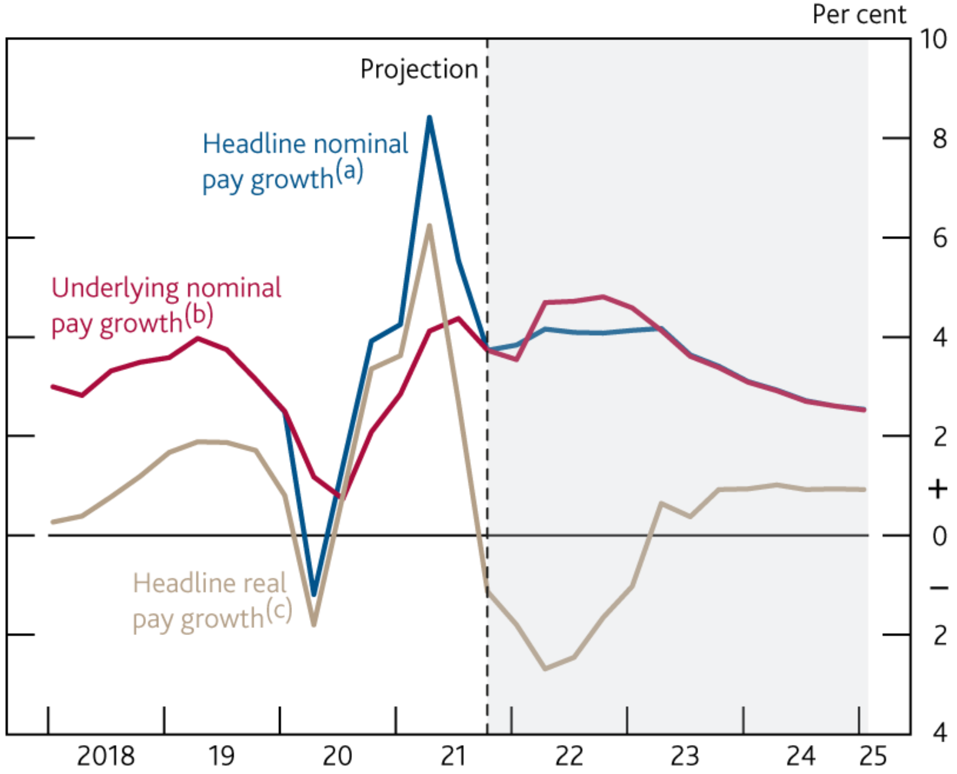

Factors affecting pay decisions in 2022




- Agents’ pay survey suggest firms plan to reach settlements of just below 5% on average, well up on recent years
- Labour market tightness the main factors, followed by higher inflation

# Underlying wage growth likely to be close to 5% before falling back

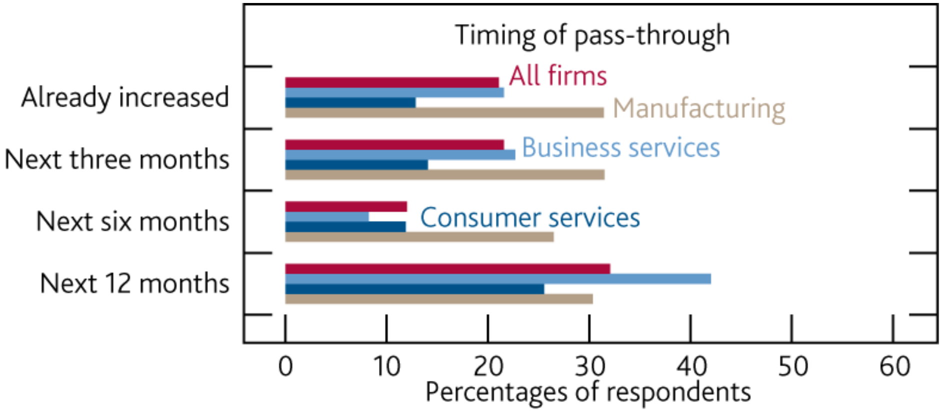
Annual growth in private sector regular pay

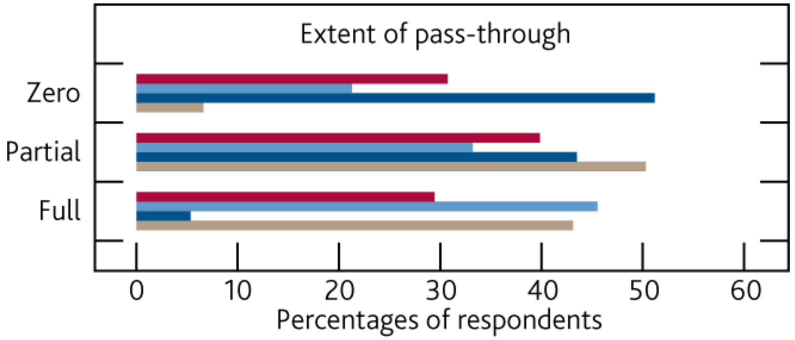



- MPC expect underlying pay growth to be close to this rate over 2022 – just short of 5% - before falling back as spare capacity builds and the cost shock wanes
- Real pay growth nonetheless falling this year

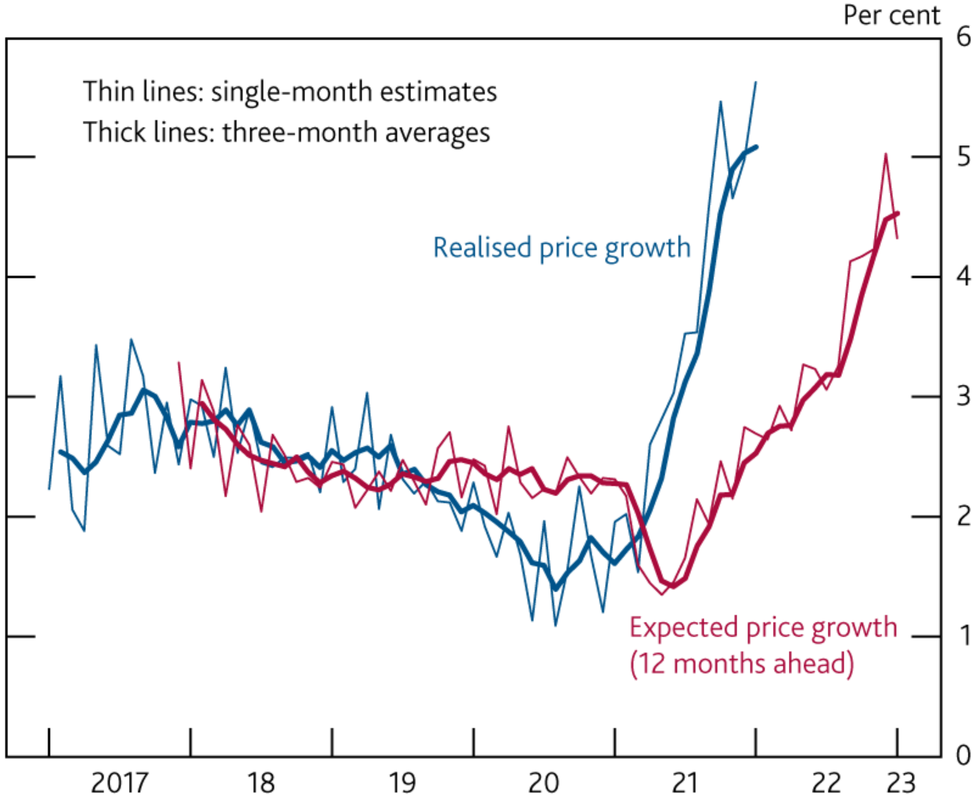
# Businesses’ pricing response crucial

Expected pass-through of higher wages to prices




Realised and expected annual firm-level price growth

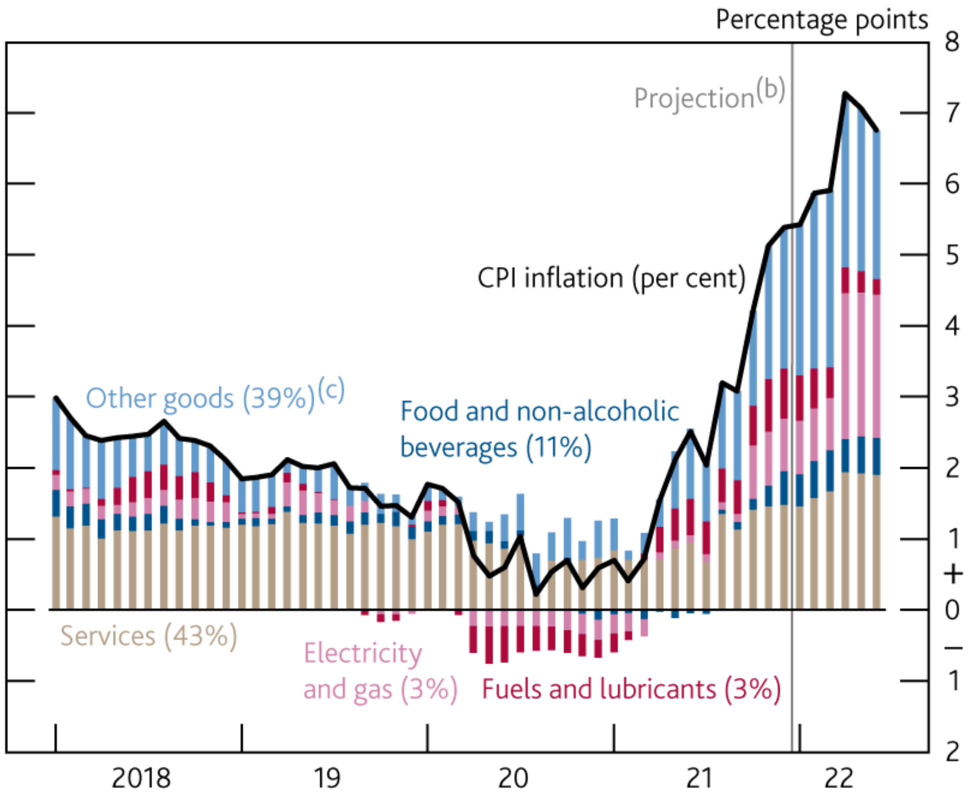



- Range of views across sectors on timing and extent of pass through of higher wages to prices…
- …but expectations of firm-level price rises have picked up sharply

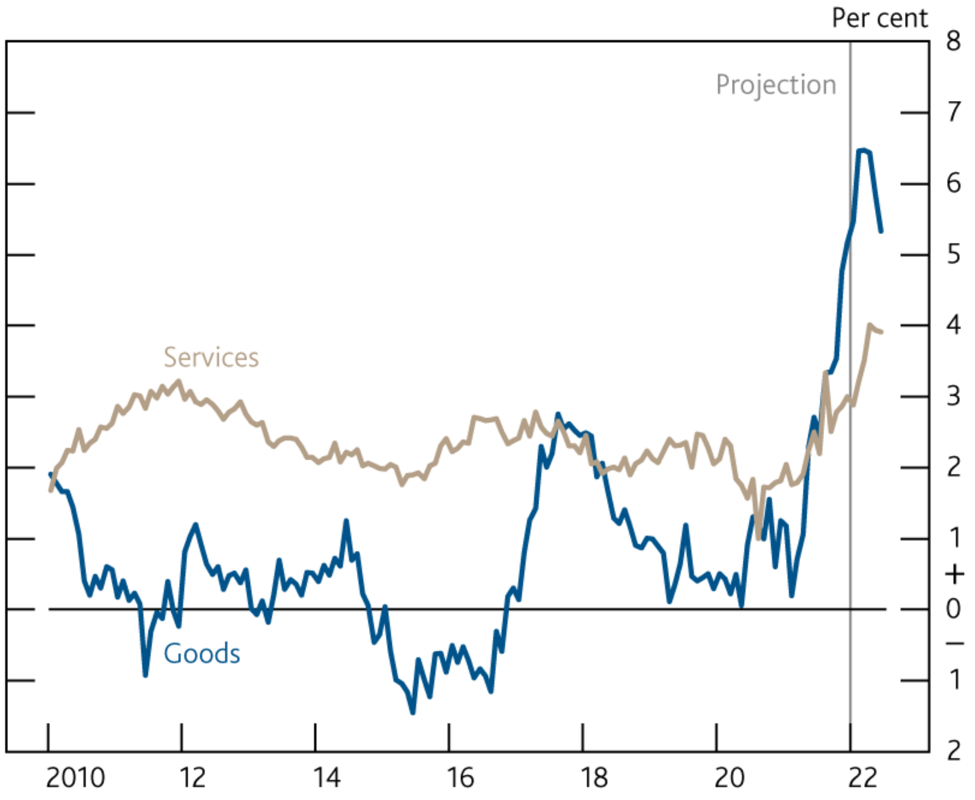
# Prices

# Inflation peaks at 7¼% in April – some signs of broadening out

Contributions to CPI inflation




Core goods and core services CPI inflation, excluding VAT

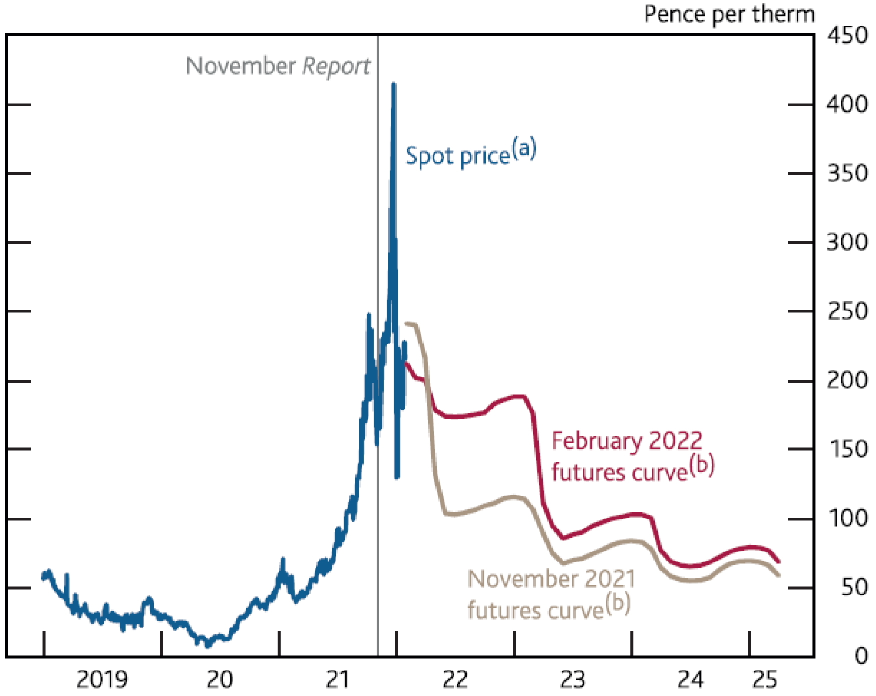



- Both energy and goods prices are still the driving force behind the further upward shift in inflation. Expected to peak at 7¼% in April
- Some signs of broadening out to services prices as domestic cost pressures pass through

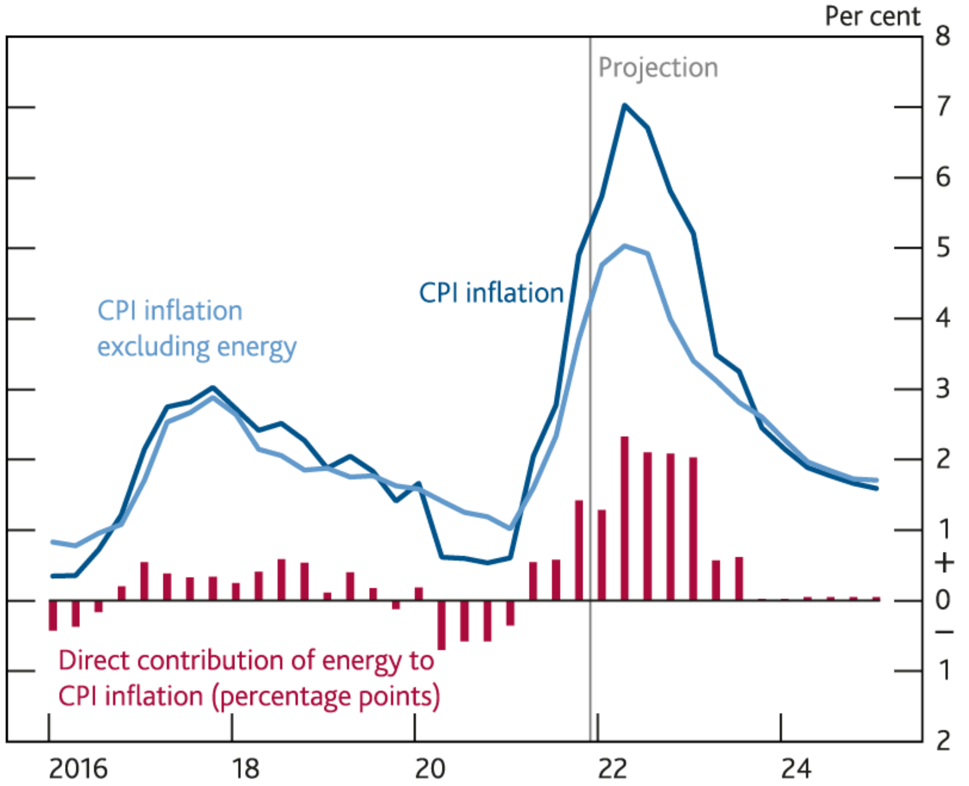
# Outlook for energy prices remains key driver

**Chart 2.20:** Gas prices remain much higher than in the past, and the futures curve has risen since November

Wholesale gas spot price and futures curves



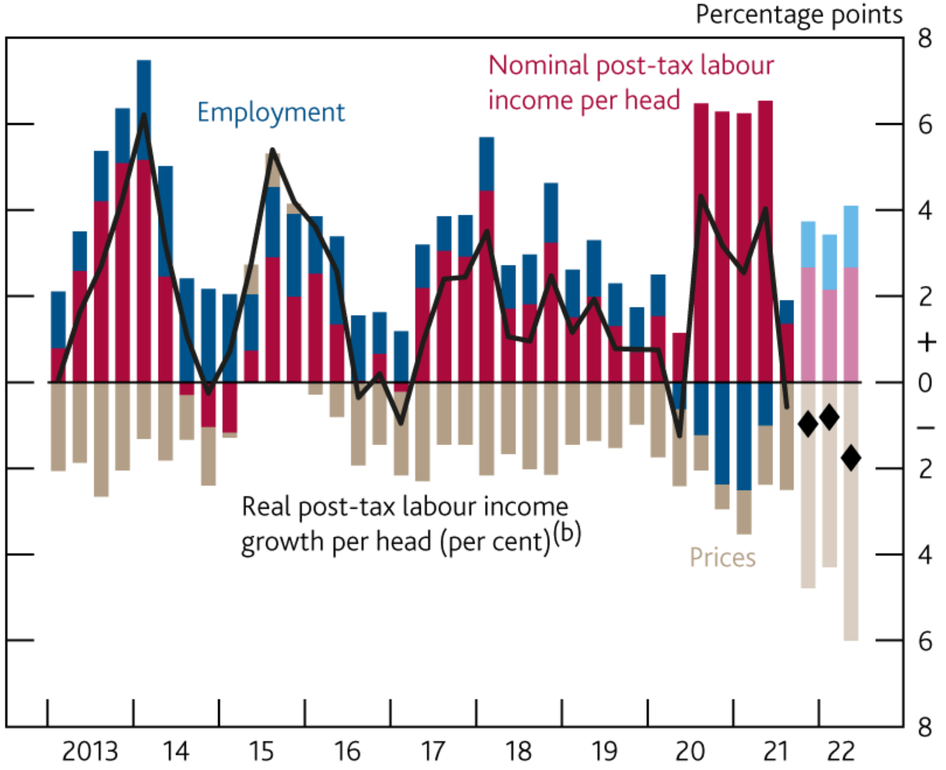

CPI inflation and CPI inflation excluding energy



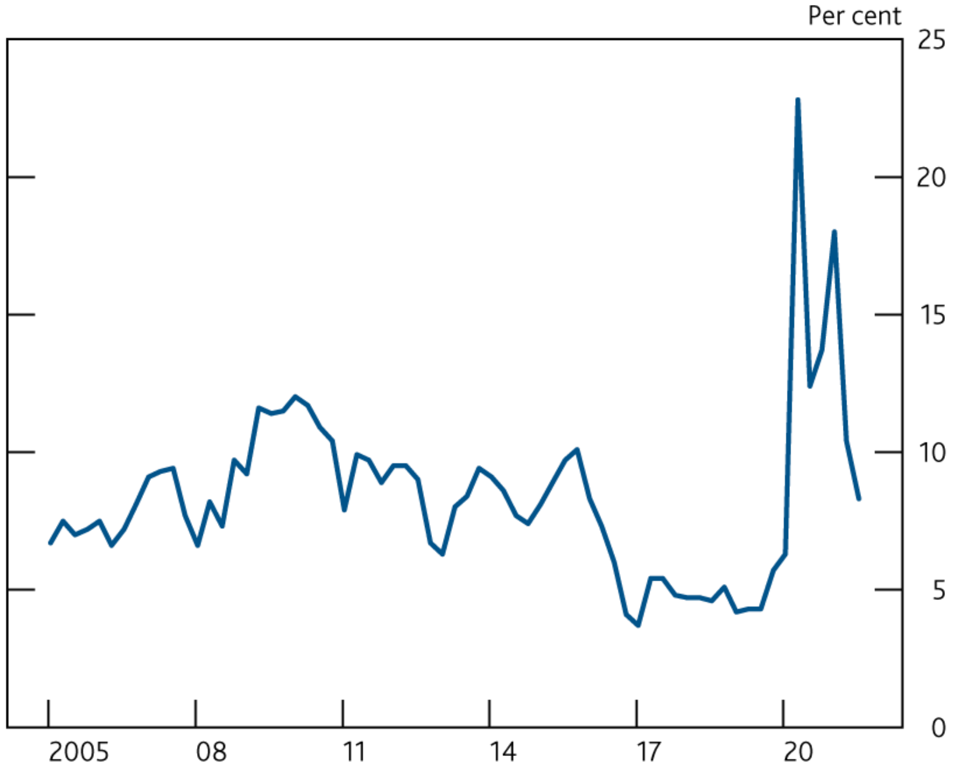

- The forecast is conditioned, as is standard practice, on the futures curve for first 6 months and then a flat profile from then on.
- Profile of futures curve is higher than November 2021 forecast.
- Energy effect wanes but never has negative impact on inflation over the forecast.

# Demand outlook crucially depends on extent of the real income squeeze and how households react to it

Contributions to four-quarter real income growth




Household saving ratio




- The rise energy and other tradeables' prices inevitably pushes down on incomes. We forecast a 2% fall this year for households.
- Households in aggregate have accumulates savings, but unevenly spread

# Forecast

# GDP and Unemployment fan projections

**Chart 1.2:** GDP growth projection based on market interest rate expectations, other policy measures as announced

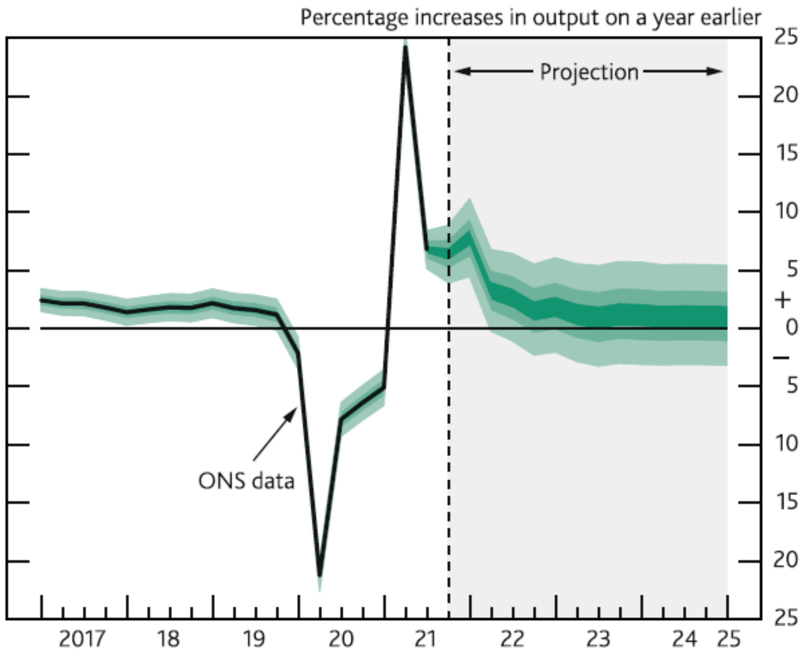
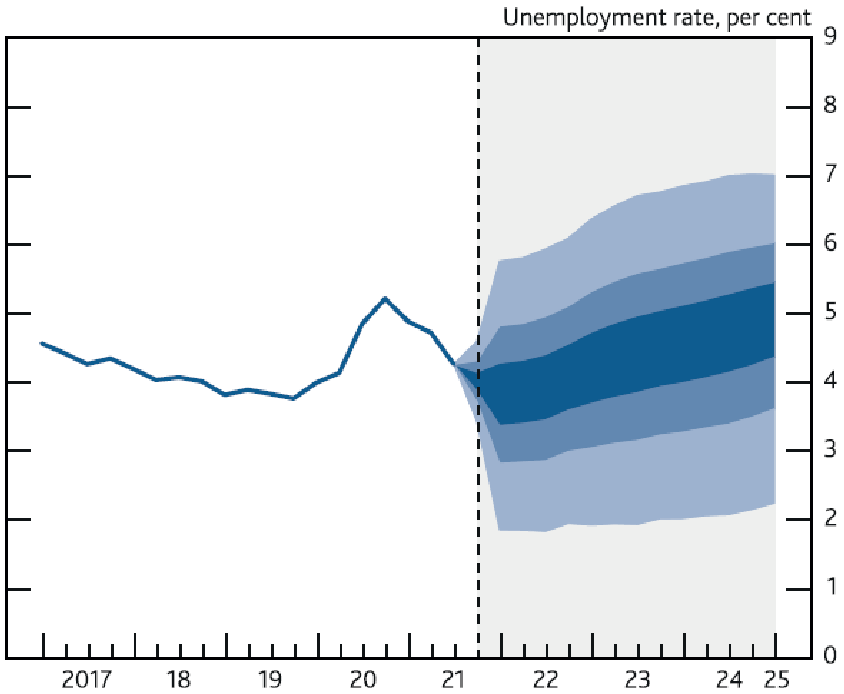


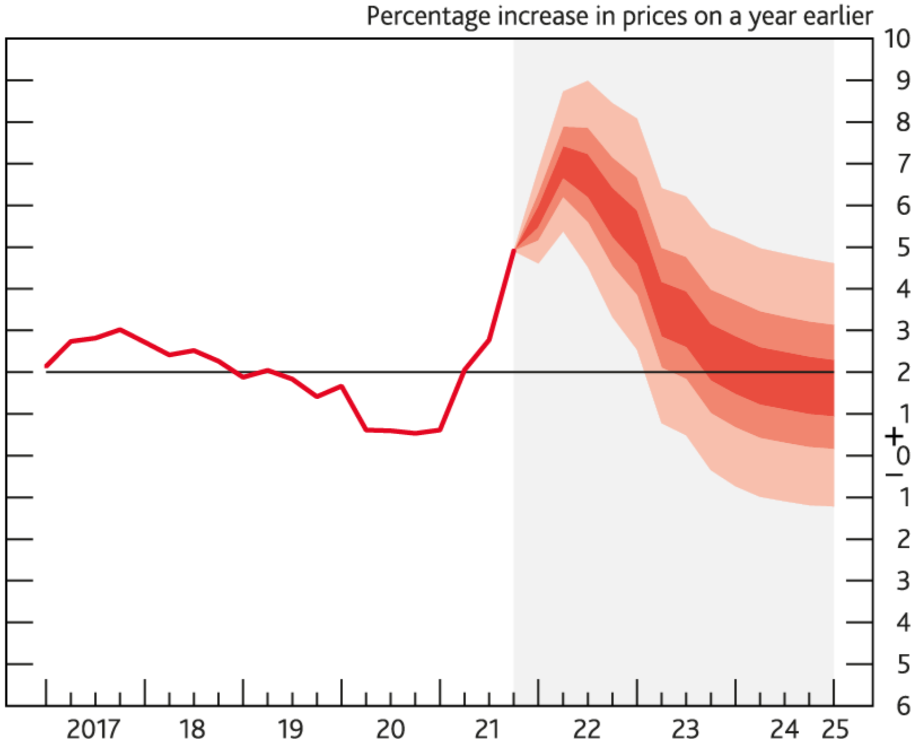

**Chart 1.4:** Unemployment projection based on market interest rate expectations, other policy measures as announced




- Household spending is relatively resilient but, nonetheless, GDP growth falls below longer term potential rates of around 1.5% to around 1% in the second and third years of the forecast
- Unemployment falls to 3.8% in Q1 but begins to rise from there as demand growth falls below supply. Rising over forecast period to 5% by the end

# CPI inflation fan

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




- CPI inflation falls back over the course of 22, to 5.2% at year 1, 2.1% at year 2 and 1.6% at year 3
- Upside risks to this from more persistence in wage growth dominate downside risks from a quicker fall in tradables' prices.
- But all hinges on energy assumptions

# Energy price risks dominate the inflation outlook

GDP growth, excess supply/demand and CPI inflation in the MPC's central projection and in the alternative scenario in which energy prices follow their futures curves throughout the forecast period

| Per cent | 2022 Q1 | 2023 Q1 | 2024 Q1 | 2025 Q1 |
|---|---|---|---|---|
| **Central projection** | | | | |
| GDP | 7.8 | 1.8 | 1.1 | 0.9 |
| Excess supply/Excess demand | +½ | -¼ | -½ | -1 |
| CPI inflation | 5.7 | 5.2 | 2.1 | 1.6 |
| **Alternative scenario** | | | | |
| GDP | 7.8 | 1.8 | 1.6 | 1.2 |
| Excess supply/Excess demand | +½ | -¼ | 0 | -½ |
| CPI inflation | 5.7 | 5.1 | 1.2 | 1.2 |

- Path for energy prices crucial for this forecast, with great uncertainty
- If prices fall back in line with futures curves, would boost demand growth, reduce spare capacity, but lower inflation further in outlying years.

# Q&A