MONETARY POLICY REPORT PRESS CONFERENCE

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Opening Remarks by Andrew Bailey, Governor

Hello, this is Andrew Bailey.

Welcome to this presentation of the Bank's May *Monetary Policy Report*.

The outlook for demand

More than a year after the start of the pandemic, Covid-19 and the actions to contain it have continued to have a dramatic and rapidly changing impact on the UK and countries around the world.

New Covid cases in the UK have continued to fall, the vaccination programme is proceeding apace, and restrictions on economic activity are easing. Recently, however, new Covid cases have increased significantly in India and some other countries.

UK GDP is thought to have fallen by around 1½% in 2021 Q1, to around 9% below its 2019 Q4 pre-pandemic level. That fall is much less sharp than was expected three months ago. As in some other countries, the impact of restrictions on activity appears to have been smaller than anticipated, as households and companies have adapted to this environment.

In the MPC's central forecasts UK GDP recovers strongly over 2021, albeit only back to pre-Covid levels. Demand growth is boosted by a decline in health risks and a fall in uncertainty, as well as fiscal and monetary stimulus. Further out, the pace of GDP growth slows as the boost from these factors wanes.

The MPC's projections are conditioned on an assumption that Covid restrictions in the UK ease in the near term in line with the plans set out by the UK and devolved administrations. Most restrictions on domestic economic activity are therefore assumed to be lifted by the end of 2021 Q2.

Demand over the next three years is also expected to be supported by households running down around 10% of the additional savings they have accumulated during the pandemic. That's larger than the 5% that had been assumed in the February *Report*, based on our interpretation of the latest survey evidence.

Overall, the level of UK GDP is higher than in the February projection over the entire forecast period.

Of course, there remains uncertainty around how the pandemic might evolve, and so there are risks around this projection – including from renewed waves of infections in the UK and other countries.

On balance, the MPC judges the risks to the central projection for GDP to be skewed to the downside in the first year of the forecast period, but broadly balanced further out. The uncertainty around the GDP projection is judged to be somewhat lower than in February, though still heightened by historical standards.

Supply and the output gap

The fall in activity over the past year has reflected a large decline in both demand and supply.

The scales of the falls in both demand and supply have made the difference between them – the output gap – difficult to gauge. A range of indicators of spare capacity are consistent with there being a degree of slack in the economy at present, however there is uncertainty about its magnitude.

Supply capacity is expected to recover sharply in the near term as firms re-open and the majority of employees on furlough return to work.

The extension of the Government's employment support schemes in the Budget is expected to limit significantly the near-term rise in the LFS unemployment rate.

The furlough scheme is currently scheduled to finish at the end of September 2021; prior to the March Budget, it was set to finish at the end of April. Over that period GDP is projected to rise substantially. As a result, the scheme is now expected to come to an end when activity is much closer to its pre-pandemic level. For example, in 2021 Q1, GDP is expected to have been around 8¾% below its 2019 Q4 level; in 2021 Q3, GDP is projected to be around 1¼% lower, on average.

Given the expected near-term recovery in activity, most of those employees on furlough are expected to return to work when the scheme ends, so unemployment is now projected to increase only slightly.

Consistent with that news, the MPC expects the medium-term equilibrium rate of unemployment to rise by less than was forecast in February.

The MPC also judges that persistent effects from Covid are likely to be somewhat smaller than previously anticipated.

In the central projection, the recovery in demand is initially expected to be somewhat stronger, resulting in a temporary period of excess demand, before demand and supply end the forecast broadly in balance.

The outlook for inflation

Turning to the outlook for inflation. CPI inflation has been quite volatile over the past year, and is likely to continue to be in the near term.

CPI inflation is currently below the MPC's 2% target, largely reflecting the direct and indirect effects of the pandemic. As has been the case in recent MPC forecasts, inflation is projected to rise in the near term as some of those effects fade. In the central projection, CPI inflation rises temporarily above the 2% target towards the end of 2021, mainly due to developments in energy prices. These transitory developments should have few direct implications for inflation over the medium term. In the central projection, conditioned on the market path for interest rates, inflation returns to around 2% in the medium term.

Overall, the risks to the MPC's inflation projection are judged to be broadly balanced. Most measures of inflation expectations have been broadly stable since the February *Report*, and the MPC continues to judge that inflation expectations remain well anchored.

Adjustment to the UK's new trading arrangements with the EU

I wanted to take a moment to mention the impact of the adjustment to the new UK-EU trading arrangements. Early evidence, including from the Bank's regional agents, suggests that many firms are adjusting to the new arrangements. According to the latest ONS data, following substantial declines in UK goods trade volumes in January, exports to the EU rebounded materially in February, although imports from the EU remained weak. However, it remains too early to judge whether the effects – both in terms of the short term disruption and the longer term effects on supply growth – are in line with the assumptions underlying the MPC's forecasts.

Therefore, as in February, the MPC has retained its assumption that trade and activity will be lower in the first half of 2021 as firms adjust to the introduction of new trading arrangements. These additional effects on trade are assumed to dissipate by the end of Q2.

The MPC's policy decision and guidance

Turning finally to the policy decision and the MPC's guidance. As I have outlined, in the MPC's central projections the economy experiences a temporary period of strong GDP growth and a temporary period of modestly above-target CPI inflation, after which growth and inflation fall back, with inflation around the target two and three years ahead.

In judging the appropriate stance of monetary policy, the Committee will, consistent with its policy guidance and as always, focus on the medium-term prospects for inflation, including the balance between demand and supply, rather than factors that are likely to be transient.

As set out in the Minutes, at this meeting the MPC decided to amend its forward guidance language to reflect the more symmetric nature of the risks to the outlook. The guidance now states that: the MPC will continue to monitor the situation closely and will take whatever action is necessary to achieve its remit.

The remainder of the language is unchanged from March. The Committee reiterated that: it does not intend to tighten monetary policy at least until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% inflation target sustainably.

At this meeting, the Committee judged that the existing stance of monetary policy remained appropriate.

The committee continues to expect the existing programme of £150 billion of UK government bond purchases to be completed by around the end of 2021. As was envisaged when the programme was announced in November 2020, and consistent with developments in financial markets since then, the Bank announced in a Market Notice alongside the MPC's decision today, that the pace of these purchases would now be slowed somewhat. The expected completion point of the purchase programme remains unchanged.

This operational decision should not be interpreted as a change in the stance of monetary policy. As measured by the target stock of purchased assets, that stance remains unchanged. That stands in contrast to the "open ended" QE programmes ongoing in a number of other jurisdictions, whereby a change in the pace of purchases would imply a change in the expected total stock of purchases.

Thank you.