BANK OF ENGLAND

Minutes of the Monetary Policy Committee meeting ending 3 June 2015

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These are the minutes of the Monetary Policy Committee meeting ending 3 June 2015.

They are also available on the Internet
http://www.bankofengland.co.uk/publications/minutes/Pages/mpc/pdf/2015/jun.aspx

The Bank of England Act 1998 gives the Bank of England operational responsibility for setting monetary policy to meet the Government's inflation target. Operational decisions are taken by the Bank's Monetary Policy Committee. The Committee meets on a regular monthly basis and minutes of its meetings are released on the Wednesday of the second week after the meeting ends. Accordingly, the minutes of the Committee meeting ending 8 July will be published on 22 July 2015.

Minutes of the Monetary Policy Committee meeting ending 3 June 2015

1 Before turning to its immediate policy decision, the Committee discussed financial market developments; the international economy; money, credit, demand and output; and supply, costs and prices.

Financial markets

2 Long-term interest rates in the United Kingdom, United States and euro area had continued to rise in the days immediately following the Committee's previous meeting, but had stabilised around the middle of the month. Subsequently, European yields had increased sharply shortly before the MPC's meeting. The increase in German government bond yields since their trough in mid-April had been particularly marked, with ten-year yields rising by around 70 basis points and 30-year yields rising by more than 85 basis points. The speed of these moves had exceeded those during the increase in US yields in the summer of 2013, during the period of focus on the future tapering of FOMC asset purchases, and during the US monetary-policy tightening of 1994. Market participants attributed the recent moves to a correction to the unusually low levels reached following the commencement of the ECB's Public Sector Purchase Programme. It was also possible that they reflected a reappraisal of the risks of deflation, particularly in the euro area. Despite the increases over the past six weeks, German yields had returned only to levels last seen in December 2014.

3 Spillovers to other asset prices had been limited. Spreads, relative to German government bonds, of most other euro-area government debt had risen a little on the month, although Greek government bond spreads had continued to fluctuate significantly. Equity prices had increased by around 1% in the United Kingdom, the United States and euro area. The euro had depreciated against both sterling and the US dollar, by around 2.0% and 1.2% respectively. The sterling effective exchange rate index had been volatile recently and was 1.9% higher than its level at the time of the May *Inflation Report* and 17% higher than its trough in the spring of 2013.

4 UK forward OIS rates stood at around 0.7% at the one-year point, rising to 1.5% at three years. Since the third quarter of 2014, a gap had opened up between forward OIS rates and economists' expectations for Bank Rate as reported by Reuters and the Bank's Survey of Economic Forecasters. In the latter, the median economist's forecast for Bank Rate was 0.8% at one year and 2.3% at three years, respectively some 10 basis points and around 75 basis points higher than equivalent OIS rates. Such a gap was not unprecedented and a similar divergence from market interest rates was currently observable in the United States, where forward OIS rates stood at 0.7% at one year and 2.0% at three years. The Committee would continue to monitor market participants' views as it sought to interpret the signal from OIS rates.

The international economy

5 Data releases during May had provided a more comprehensive picture of the pace of global activity since the beginning of the year, following the weakness in the Q1 GDP figures released during April for the United Kingdom, United States and China. Assessing the breadth and persistence of any global slowdown would be an important factor in judging domestic prospects.

6 GDP growth in the euro area had been 0.4% in 2015 Q1, in line with Bank staff expectations, although there had been considerable variation across Member States. Activity in France and Italy had surprised to the upside and growth in Spain had remained healthy. Set against that, GDP in Germany had risen by only 0.3%, weaker than expected. Much of this weakness had reflected strong imports growth and a reduction in stockbuilding; final domestic demand growth had suggested continuing underlying economic strength. Across the euro area as a whole, Bank staff continued to expect growth of 0.5% in the second quarter. There were downside risks from the possibility of a disorderly outcome of the Greek debt negotiations. It remained unclear whether the Greek government had the means to make forthcoming repayments to the IMF and ECB due during June and July.

7 Activity in the United States was estimated to have contracted by 0.2% in 2015 Q1, according to the second GDP release. The underlying pace of growth in the United States remained difficult to assess. There were a number of special factors, including the West Coast port strike and poor weather in the North East, that would temporarily have depressed GDP growth in Q1. There was also a degree of uncertainty over the seasonal adjustment of the data in the first quarter. Although some recent indicators of consumer confidence and household spending had weakened, business surveys and capital goods orders in May had suggested some recovery in growth in the second quarter and housing starts had picked up strongly. Employment growth had also recovered in the data for April. Bank staff expected GDP growth of 0.6% in Q2, a little weaker than previously expected.

8 Growth in China had slowed to 7.0% in the four quarters to 2015 Q1 on the official data and Bank staff expected it to remain below the post-crisis average in the second quarter. On the month, indicators had corroborated that softer outlook with data on both industrial production and retail sales remaining weak. A decline in the ratio of new lending to GDP indicated that growth was becoming less credit-intensive, notwithstanding successive moves to loosen monetary policy. This might reflect some rebalancing of the economy away from investment, which tended to rely more on credit. It was also possible, however, that the loosening in domestic policy was being more than offset by the depressing impact of the increase in the exchange rate, which had risen by over 10% in effective terms over the past year.

9 Taken alongside the available outturns for GDP growth in the rest of the world, which on balance had shown a slowing on the quarter, these data pointed to global growth of around ½% on a PPP-weighted basis in 2015 Q1. That would be the weakest quarterly growth rate since the crisis-induced recession, although activity growth weighted by countries' importance for UK trade had probably been closer to its long-run average. It was difficult to point to any common factor bearing down on activity across countries, but indicators of consumption had generally remained surprisingly weak following the boost to real incomes resulting from the fall in oil prices

in the second half of 2014. It was possible that the boost to consumption from this source would become more evident over time, and surveys of aggregate activity in the second quarter were indicative of some recovery. Bank staff continued to expect global growth of 0.9% in Q2, but, given the uncertainty over the cause of the Q1 slowdown, there was a chance that the weakness might prove more persistent.

Money, credit, demand and output

10 At the time of the May *Inflation Report*, the Committee had expected that the surprise decline in UK GDP growth in 2015 Q1 would prove to be temporary. Bank staff's expectation had been that the preliminary estimate of 0.3% growth would eventually be revised up to 0.5%, and that growth in Q2 would be stronger, at 0.7%. Data developments during the month had left those judgements intact.

11 In the second estimate for 2015 Q1, headline GDP growth, at 0.3%, had not been revised, with upward revisions to industrial production and construction output offset by a weaker estimate of service sector growth. The expenditure breakdown indicated that consumption growth, at 0.6%, had been 0.1 percentage points weaker than forecast in the May *Inflation Report*. Net trade had also been a source of downside news, subtracting 0.9 percentage points from quarterly growth, reflecting unexpectedly strong imports rather than disappointing exports. By contrast, investment had been stronger than anticipated, with business investment estimated to have grown by 1.7% and housing investment by 1.6%. Stockbuilding had also contributed more to demand than had been forecast. Although uncertainty around initial national accounts estimates was high, it was notable that consumption growth had disappointed in two consecutive quarters. The outlook for consumer spending was the main issue of discussion this month.

12 Consumer spending, both in the UK and elsewhere, might have been weaker than expected because households had saved more of the windfall from lower energy prices than anticipated, perhaps because of doubts that the price falls would be sustained. It would be hard to confirm or refute this hypothesis until further data regarding household income and saving became available. In any case, it was by no means clear that consumption growth would remain weak. Although consumer confidence had fallen on the month, the balances relating to households' views of the general economic situation and their own financial situation had remained above their historical averages; and retail sales had risen by 1.2% in April, more than reversing the previous month's surprising fall.

13 Developments in credit markets had also been suggestive of a positive near-term outlook for household demand. Consumer credit had risen by 0.7% on the month in April, and was 7.2% higher than a year earlier. This strength appeared to be a result not only of growing household demand but also of increased competition among credit providers, which had been evident in declining interest rates on some personal loans. In addition, mortgage approvals for house purchase had risen in April to 68,000. And although lending secured on dwellings had as yet remained subdued by historical standards, provisional results from the May RICS survey had reported a marked rise in new buyer enquiries and in house price expectations, which might be expected to spur further mortgage demand.

14 The findings of the latest survey of households by NMG Consulting on behalf of the Bank had supported the Committee's forecast that consumption growth during 2015 would be similar to that seen in 2014, with a similar balance of households reporting a planned increase in spending over the next year as had reported an increase in spending over the previous year. More highly indebted households had reported relatively robust spending growth, both in the past and in their future plans, seemingly consistent with the Committee's judgement that credit headwinds were easing somewhat. Younger respondents had reported expectations of strong income and spending growth, which seemed consonant with the marked fall in unemployment experienced by this cohort over the past couple of years. Respondents aged 65 and over had reported similarly strong income and spending expectations, which was perhaps associated with rising labour market participation by this age group.

15 The new government had announced its intention to present an updated Budget on 8 July. The May *Inflation Report* projections had been conditioned on the public finance forecasts contained in the March Budget, and it was as yet unclear to what extent the updated projections would differ materially from those. The Committee would have the chance to assess the updated fiscal projections in the preparation of its August *Inflation Report*.

16 The May business surveys had been somewhat mixed. The CBI had reported strong output growth in the services sector and in distributive trades, whereas manufacturing orders were reported to have softened. The composite Markit/CIPS survey had recorded a second consecutive decline in the output index but an improvement in output expectations. On balance, Bank staff judged that these releases contained little material news about aggregate activity in Q2.

Supply, costs and prices

17 The twelve-month CPI inflation rate had fallen to -0.1% in April from 0.0% in March. As in recent months, the movements in both the aggregate index and its sub-components had been in line with the expectations of Bank staff. The decline in the inflation rate between March and April had been accounted for by a reduction in the contribution from the prices of transport services, related to the proximity of the CPI collection date in April 2014 to the Easter holidays. This mechanical effect would disappear in the data for May 2015: Bank staff anticipated a pickup in CPI inflation to around 0.1%.

18 The outlook for inflation thereafter remained similar to the one described in the May *Inflation Report* and the accompanying open letter from the Governor to the Chancellor of the Exchequer. Around three-quarters, or 1½ percentage points, of the deviation of inflation from the 2% target in April had reflected unusually low contributions from energy, food, and other imported good prices. Absent further movements in global commodity prices or the exchange rate, these effects on twelve-month CPI inflation were expected to dissipate so that inflation was likely to pick up notably towards the end of the year. The remaining quarter, or ½ percentage point, of the deviation of inflation from the target had reflected the weak growth of domestic costs, especially wages. And it was upon these, together with any persistent effects of sterling strength, that the outlook for inflation in the medium term depended.

19 There had been little news during the month regarding measures of inflation expectations, which appeared to be broadly consistent with the inflation target. The inflation expectations of independent forecasters surveyed by HM Treasury had fallen, although they were similar to the Committee's own projections for 2015 and 2016 and only a little lower for 2017. Households' inflation expectations one year ahead had fallen very slightly, according to the Citigroup/YouGov survey, but expectations five to ten years ahead had been flat. The Bank/GfK survey, by contrast, had reported slight increases at the one, two and five-year horizons.

20 As described in the May *Inflation Report*, wage growth was expected to pick up over the coming quarters, reflecting a further narrowing in the margin of slack in the labour market and a gradual recovery in productivity. Consistent with that, the most recent data had shown a slight firming in wage growth. In the year to 2015 Q1, whole economy regular pay had increased by 2.2% – a rate one percentage point higher than six months earlier – broadly as expected in the May *Report*. Private sector regular pay growth had increased to 2.7% over the same period. The latest LFS micro-data had indicated that shifts in the composition of employment towards those with shorter tenure, fewer qualifications and employed in occupations typically attracting lower pay levels might be subtracting about 0.8 percentage points from average pay growth. Abstracting from these factors, therefore, it was possible that underlying private sector pay had been increasing at an annual rate of around 3½%. Additionally, there were signs of a recovery in job market dynamism and confidence on the part of employees from the fact that job-to-job flows, or labour-market 'churn', had returned almost to pre-crisis levels. Voluntary resignation rates had also increased – although so far only to a level lower than pre-recession norms.

21 There remained an open question about the extent of any further wage acceleration. To the upside, it was possible that the unemployment rate might continue to fall more briskly than assumed causing increased pressure on pay rates relative to productivity, and therefore on medium-term inflation. To the downside, it was possible that the past and prospective period of near-zero headline CPI inflation would dampen wage settlements, thus prolonging the period of historically subdued pay growth. This would be especially likely if firms and households expected inflation to remain below the target for a protracted period.

22 Employment had risen by 202,000 in the first quarter and the unemployment rate had declined as expected to 5.5% in 2015 Q1 from 5.7% in 2014 Q4. The participation rate had increased by 0.2 percentage points, to 63.5%, while average hours per worker had declined a little. The net migration inflow had been 318,000 over 2014 as a whole, compared with 298,000 in the year to 2014 Q3. Over the past two years the unemployment rate had fallen by 2.3 percentage points. At the time of the May *Inflation Report* projections, the Committee's central expectation was that the decline in the jobless rate would ease to around ¼ percentage point or less per year as it fell closer to its assumed long-run sustainable level of about 5%.

23 The Committee discussed whether there were any signs in the latest data that the pace of the decline in the unemployment rate was beginning to ease as anticipated. In the three months to March, the decline in the LFS rate had been the smallest since the summer of 2013. And the claimant count rate had been unchanged at 2.3% between March and April. Survey indicators of employment growth had showed some tentative signs of levelling off in the most recently available data, albeit at healthy levels. The vacancy rate had remained high, continuing to point to robust labour demand. Bank staff analysis had indicated that, if the rates at which individuals moved between the various labour market states – employment, unemployment, and inactivity –

were to remain around their current levels, then the unemployment rate could be expected to level off fairly soon. But, since those labour market flow rates would themselves change as conditions evolved, it was unclear how useful the current rates were in practice as a guide to the future evolution of unemployment and the consequent tightness of the labour market.

24 Overall, it was too early to tell whether the reduction in the rate of unemployment, or the pace of absorption of labour market slack more broadly, was beginning to ease off. Ultimately, the key uncertainty remained whether productivity growth would begin to rise to historically more normal rates, so that a healthy expansion of output and real income growth could be maintained without the continued absorption of labour resources, and therefore without generating excessive cost and price pressure in the medium term.

The immediate policy decision

25 The Committee set monetary policy to meet the 2% inflation target in the medium term, and in a way that helped to sustain growth and employment. There had been relatively little news in the economic data in the weeks since the Committee had last met and since the publication of the May *Inflation Report*. Consequently, Committee members' views on the economic outlook, and the appropriate stance of monetary policy that it implied, had not changed materially.

26 As expected, twelve-month CPI inflation had declined to -0.1% in April, primarily reflecting the effect on recorded airfares of the timing of the Easter holidays. That effect would disappear from the inflation calculation in the May data. More broadly, the Committee judged that CPI inflation was being depressed by around 1½ percentage points relative to the target by the unusually low contributions from the prices of energy, food and other imported goods. Much of the effect of these factors on twelve-month CPI inflation was likely to dissipate fairly shortly, so that inflation was likely to rise notably towards the end of the year. The past appreciation of sterling had the potential to impart a somewhat more persistent negative impact on inflation, however.

27 The Committee judged that the remaining ½ percentage point of the deviation of CPI inflation from the target reflected the impact of weak domestic cost growth, and weak wage growth in particular. It was upon these, together with any persistent effects of sterling strength, that the outlook for inflation in the medium term depended. There had been mounting evidence that pay growth had picked up relative to a year earlier. And it was possible that underlying pay growth in the private sector, after accounting for the negative impact on average pay levels of the composition of employment growth, could be running at an annual rate somewhat stronger than the AWE measure. Although there were tentative signs from the business surveys that labour demand might be levelling off, it remained strong, and the number of job vacancies per unemployed person had risen to its highest since 2008. There was a range of uncertain factors that would influence the path of wage growth, and therefore inflationary pressure over the medium term, including: the potential influence of the current period of near-zero inflation; whether productivity growth would pick up; and, relatedly, whether the pace of the decline in unemployment would slow as anticipated. There had, however, been little in the data as of yet to challenge the view set out in the May *Inflation Report*.

28 The UK GDP data for 2015 Q1 had been disappointing, although the Committee's view was that the dip in growth would prove to be temporary and that growth would be stronger in Q2. It was, nevertheless, notable that first quarter growth had been relatively weak in a number of countries.

29 Inflation was below the target, even after abstracting from the temporary impact of the prices of imported goods and energy, and the Committee judged that there was at least some underutilised capacity remaining in the economy. It remained appropriate, therefore, to set monetary policy in order to support growth and to absorb remaining economic slack, and so to facilitate the rise in domestic costs needed to return inflation to the target within two years. For some time, the policy setting had needed to counteract the significant headwinds of the lingering impact of the financial crisis on credit conditions and indebtedness, domestic fiscal consolidation, and subdued global demand. The Committee considered recent developments in each of these.

30 Credit conditions had eased substantially over the course of the past few years. In the NMG Consulting/Bank of England survey, indebted households had reported relatively robust spending growth in the past and intentions for the future. Unsecured lending growth had picked up, at least partly reflecting increased competition between, and credit supply from, lenders. Mortgage rates had continued to fall: for instance, the average quoted rate on new two-year fixed rate mortgages at a 75 per cent loan-to-value ratio had fallen to 1.9% in May, a series low. In this context, the Committee noted that the tools available to the Bank's Financial Policy Committee and other regulators were the first line of defence against any financial stability risks that might arise in the housing market.

31 The new government's budget plans would be announced at the beginning of July. Based on the announcements made so far, it was unclear to what extent the new plans would differ from those already incorporated in the Committee's economic projections. In any event, it was likely that fiscal consolidation would continue to weigh on growth for some time.

32 The recent evidence on the global economy had been mixed. By comparison with six months earlier, prospects for growth in the euro area appeared somewhat brighter, notwithstanding some recent softer data. But a disorderly outcome to the Greek debt negotiations remained a significant risk. There was also evidence of a continuing slowdown in China, where policy had recently been eased, in part to offset the impact of the appreciating exchange rate. In the United States, the most recent data had been difficult to interpret, as the slowdown in the first quarter had been exaggerated by a set of idiosyncratic factors. More broadly, growth in a number of countries had been weak in the first quarter. The Committee's judgement was that global growth would resume at a steady, if not spectacular, pace in the second quarter and beyond. For some members, it now appeared that the boost to global, as well as UK, activity from the reduction in oil prices in the second half of 2014 had been less than anticipated – perhaps reflecting continued caution on the part of households and firms who might be inclined to save such windfalls, at least initially. For others members, the recent data were less concerning: the impact of higher real incomes on spending would be felt only with a lag and was likely to build over time if oil prices remained significantly below their mid-2014 levels, as the relative abundance of oil inventories and supply suggested was likely.

33 As the Committee had noted previously, the strength of the headwinds to growth had begun to ease. As they eased further over time, the interest rate required to keep the economy operating at normal levels of capacity and inflation at the target was likely to continue to rise. Given the global nature of many of these headwinds, this would be true in several other countries besides the United Kingdom. The pace at which those countries began to embark on a normalisation of monetary policy would depend on their own individual circumstances. Those policies could have international spillovers. However, the Committee agreed that the path for UK monetary policy would depend on the prospects for inflation in the United Kingdom and would not be determined by the actions of other central banks.

34 The MPC had given guidance in its February 2014 *Inflation Report* on how it would seek to achieve the inflation target over the policy horizon. The central message of that guidance remained relevant: given the likely persistence of headwinds weighing on the economy, when Bank Rate did begin to rise, it was expected to do so more gradually than in previous cycles. Moreover, the persistence of those headwinds, together with the legacy of the financial crisis, meant that Bank Rate was expected to remain below average historical levels for some time to come. The actual path Bank Rate would follow over the next few years was uncertain, and would depend on economic circumstances. The Committee's guidance on the likely pace and extent of interest rate rises was an expectation, not a promise.

35 Overall, the developments since the previous MPC meeting had been limited and, in the main, consistent with the expectations that the Committee had set out in its May *Inflation Report*. In light of that, all Committee members agreed that it was appropriate to leave the stance of monetary policy unchanged at this meeting. For two members, the immediate policy decision remained finely balanced between voting to hold or raise Bank Rate.

36 The Governor invited the Committee to vote on the propositions that:

Bank Rate should be maintained at 0.5%;

The Bank of England should maintain the stock of purchased assets financed by the issuance of central bank reserves at £375 billion.

Regarding Bank Rate, the Committee voted unanimously in favour of the proposition.

Regarding the stock of purchased assets, the Committee voted unanimously in favour of the proposition.

37 The following members of the Committee were present:

Mark Carney, Governor
Ben Broadbent, Deputy Governor responsible for monetary policy
Jon Cunliffe, Deputy Governor responsible for financial stability
Nemat Shafik, Deputy Governor responsible for markets and banking
Kristin Forbes
Andrew Haldane
Ian McCafferty
David Miles
Martin Weale

Dave Ramsden was present as the Treasury representative.