BANK OF ENGLAND

MEETINGS OF THE MONETARY POLICY COMMITTEE

November 2015

A meeting of the Monetary Policy Committee was held on Monday 2 November 2015. The following members of the Committee were present:

Mark Carney, Governor
Ben Broadbent, Deputy Governor, Monetary Policy
Jon Cunliffe, Deputy Governor, Financial Stability
Nemat Shafik, Deputy Governor, Markets and Banking
Kristin Forbes, External Member
Andrew Haldane, Chief Economist
Ian McCafferty, External Member
Gertjan Vlieghe, External Member
Martin Weale, External Member

Dave Ramsden was present as the Treasury representative

Anthony Habgood was present as an observer in his role as a member of the Oversight Committee of Court

The following members of staff were present:

Gareth Ramsay, Director, Monetary Analysis
Fergal Shortall, MPC Secretariat
Simon Hayes, MPC Secretariat
Venetia Bell, MPC Secretariat
Melissa Davey, Editor of Inflation Report

Transcript of the Monetary Policy Committee Meeting on

Monday 2 November 2015

Governor Carney. Good morning everyone. Andy, give us an update on recent data.

Andrew Haldane. Thank you. So one or two bits and pieces, the majority of which I think are captured in the background note on the data which you got on Friday. But just running through those very quickly. For the euro area, since we last met we've had some inflation data which was a touch to the downside. In the US we had the Q3 GDP data and some wages and salaries data, neither of which in and of themselves I think contained a huge amount of news relative to the forecast we are about to publish. And then, just this morning, we've had some manufacturing PMIs for the euro area, for China, and for the UK. For the euro area they are up a bit in October, even relative to the flash estimate. In China they are also up in October from September. And to complete the set, there was a short increase in manufacturing PMIs for the UK in October, indeed up to their highest levels since June 2014.

We had the composites you'll remember at Pre-MPC. That's the first of the components, we'll get services tomorrow. Just completing the picture on the UK, we've had some Halifax house price data for October. That was up 0.6%, broadly speaking in line with our expectations. We've had the GfK consumer confidence numbers for October, they were very slightly up. And we've had the REC Recruitment Survey for October, which, generally speaking, points to a picture of continuing tightness in the labour market, although within that I would say though that wages and salaries picture from the REC is now much more in line with the readings we've had from the AWE. The inconsistency between those is now much less clear than was the case six months ago.

Thanks very much.

Governor Carney. Thank you Andy. Alright, we'll start in. Jan I'll give you fair warning, contrary to convention I'm going to have you go after Ben, if you don't mind. And it's just a product of the machine coming up with that ordering. So Ben, please.

Ben Broadbent. Thank you Governor. When we last met, risk sentiment had again deteriorated significantly over the previous few weeks. For the second month in a row the major equity markets all weakened significantly in September, and at the time of our October meeting were 10% below their levels at the time of the previous Inflation Report. As poorly as equity markets performed over that period, bond markets did well: our own interest rates fell sharply, providing a much-changed backdrop for the November Inflation Report. And we've been wrestling with those shifts and the implications of that 50 basis point drop in forward interest rates, for the past couple of weeks.

During that time, as it happens, some of these swings in asset prices have been reversed. Though still quite a bit lower than in August, one-year sterling interest rates one year forward are 15 basis points up on their recent trough. During October global equity prices in aggregate regained close to three-quarters of that 10% lost over the previous two months. The average share price of UK-facing companies is now exactly the same as it was at the time of the August Inflation Report.

I remain of the view that these swings are too large, over such short periods of time, to arise solely from changes in the central expectation of global growth. That applies as much to the bounce in prices over the past two or three weeks as it did to the sell-off over the previous couple of months.

Certainly the news in the actual economic data has been relatively moderate. In China, activity indicators have been stable, albeit at weaker levels than in the past. The manufacturing PMI, stable at just below 50, is the latest example. Whole-economy growth in the third quarter of this year was slightly weaker in both the US and the UK than had been expected three months ago in August, but only by 0.1% percentage point. And both were in line with what was expected this time a month ago.

Euro-area growth also looks to be in line with prior expectations and its composite PMI rose slightly in October.

So a more feasible explanation for these big swings, in the equity markets and other financial markets, is there have been smaller changes in the perceived likelihood of very bad economic developments, perhaps in Asia or EMs more generally. Small changes in tail risks can have significant effects on asset markets, including on risk-free yields. It's also possible that markets have been driven partly by news about monetary policy. In the United States, markets will naturally be more sensitive to economic data the closer the FOMC to raising interest rates. Fed communication also seems to have led to some volatility. And perhaps some other central banks – including the ECB and BoJ – have also surprised markets in the past month.

To my mind, these things make it more likely that the swings in interest rates on which we condition our forecasts could or should have some net impact at least on projected growth. A yield curve depressed by unusually elevated risk premia might be expected to boost expected activity, the mean as well as the median. If rates are lower because the central banks have become collectively more dovish then, all else equal, this too would benefit global activity, if only at the margin.

So while I think it makes sense to ask oneself why the rate curve might have fallen – and in particular to allow for the impact of worsening risk sentiment on our own exports, investment and domestic economic activity – I also think it's important not to overweight these things.

Now turning to that domestic picture it has actually, in the data, been a relatively stable one. Growth, as I said, came in slightly weaker in Q3 than we'd expected in August, though in line with the more recent forecasts. GDP has clearly decelerated over the past year. But the near-term indicators, in particular the PMIs, have stabilised at a level consistent with that 0.5% to 0.6% rate, at least for the time being. After the downwards blip in the official data in the second quarter, employment growth looks to have resumed in the third. The near-term surveys do not suggest a very rapid growth in employment nor, in particular, anything much faster than the underlying growth of expansion of labour supply. Wage growth has certainly picked up and, despite better productivity, so has the growth rate of unit wage costs; but that growth rate is below average and below what it is likely to have to be to ensure on-target inflation in two years.

There will be forces pushing UK demand in various directions over the next few months. After a significant but one-off boost from lower oil prices, consumption growth will not be sustained at the rate we've seen this year. Housing investment and construction output will do better, one suspects. Globally, emerging markets are slowing and we have downgraded our estimates of the medium term sustainable trend. But the euro area is doing better and shows little sign, as yet, of suffering from that EM slowdown. Much will depend, I suspect, on which of those trends dominates.

But that can wait. My firm intention for this month's meeting is to vote on Wednesday for no change in either Bank Rate or the stock of purchased assets.

Governor Carney. Thank you, Ben. So I have Jan and then Jon please.

Gertjan Vlieghe. Thank you. We have had a very volatile period in financial markets since the summer, and I too wanted to step back and recap some of the net movements over the period.

Although the US stock market indices have largely recovered and are back to their early-August level, this is not the case for other stock market indices.

The UK All-share and Eurostoxx indices remain 5% below their early-August level. The Nikkei is down 7%. The MSCI Emerging Market index – which only has a relatively small China weighting - is down 6%. And Chinese A-shares are still down 9% over that same horizon.

When looking at interest rate markets, the most notable moves have been a flattening of the expected path of interest rates, with ten-year yields relatively little changed, other than in the eurozone where expectations of increased QE have probably had an effect. US rate expectations in, for example, two years' time, are 33 basis points lower, UK rate expectations are 40 basis points lower, euro area rate expectations are 18 basis points lower.

The dollar a little stronger against most EM currencies and sterling, unchanged against the euro and a little weaker against the yen.

Commodity prices continued their downtrend: the CRB commodity price index was down another 4% against since early August.

Corporate credit spreads, after widening sharply and narrowing again, remain well above their early August levels.

China, India, New Zealand and Norway central banks cut their policy rates over that same period and the ECB has given strong hints of further future QE and a modest future rate cut.

I think this tells a consistent picture of lower growth expectations, accompanied by heightened risk aversion and central bank action, in the form of either outright accommodation, anticipated accommodation, or delayed tightening.

That's a backdrop against which it was entirely reasonable to make downward revisions to our own global growth outlook, as is now reflected in the November forecast. I don't think we overreacted. I am more comfortable with a medium-term outlook for global growth that does not feature a meaningful acceleration anymore, in line with my view that debt and demographics will keep growth persistently lower than before the crisis.

Turning to the domestic outlook, several patterns that we have been discussing over the past few months remain in place.

Domestic growth has continued to slow gently from its 2014 peak pace. Year over year growth to Q3, at 2.3%, was 0.8 percentage points lower than the peak growth rate of 3.1%. The loss of momentum has also been apparent across a wide range of surveys, with manufacturing slowing sharply and services slowing more mildly, but slowing nevertheless.

Thinking about the growth outlook, I see two negatives and two positives.

I remain concerned about the extent to which fiscal drag will weigh on growth, a process that is only just beginning after a few years of relatively little fiscal drag.

I also remain concerned about the extent to which the weaker growth environment will weigh on UK business investment, and I note that our business investment forecast remains very strong, and is actually stronger than in August.

On the positive side of the ledger, I think the housing market is likely to continue its recovery, and that will have positive effects on overall growth, both via consumption and housing investment. The housing market has been a good leading indicator of overall growth momentum before. Even if much of it is not causal, and the housing market is simply a timely reflection of households' income expectations, we should still pay attention to it.

A second positive factor is that I am cautiously optimistic that the recent pick-up in productivity growth can be maintained. I note the anecdotal and survey evidence that companies are putting in place productivity-enhancing investment to a greater degree now. Stronger productivity growth will put the recovery on a sounder footing, and will better support income growth, making consumption growth potentially less reliant on further reductions in the savings rate.

Turning to inflation, I remain concerned that nominal variables are not growing fast enough. The best of the bunch is core inflation, which remains weak at 1% but at least shows some near term upward momentum on my interpretation, which is encouraging. My reading of the wage data is a rather pessimistic one. After a pick-up to above 3% in the spring, I note that, when looking at private sector pay growth excluding bonuses, the three-month, six-month and nine-month growth rates have all dropped below 3% again. The recent momentum is, if anything, down, not up. And the surveys relating to pay are not showing upward momentum either. The low level of the unemployment rate and the reported tightness of the labour market give us a good economic reason to expect a further pick-up in pay growth. But when examining the data through the lens of an agnostic short-term forecaster I am rather more sceptical and need to see it to believe it.

I also note that the inflation expectations surveys are a little below where we would like them to be, both for households and for corporates. Once headline and core inflation tick up, there is a good reason to expect the expectations to tick up as well, but again, I would like to see it. Especially as commodity price news keeps delaying the rise in headline inflation that we ourselves expect.

Finally, I'd like to say a few words about the yield curve.

We treat the yield curve as the modal expectation of market participants. We know this is only a rough approximation, because we are making two errors. First, the yield curve reflects the whole distribution of expected outcomes, not just the mode. Second, the yield curve reflects what is known in finance theory as "risk-neutral" expectations, while we are really interested in "risk-adjusted" expectations, ie, adjusting for risk premia. We do not have the tools to take on board the full risk-adjusted market expectations in our forecast. No reliable models and estimates exist for us to work with.

Market intelligence suggests many market participants have a modal path in mind that has rate hikes starting earlier than Q1 2017. But they also see a non-trivial risk of a rate cut at some stage, should further downside risks materialise. And heightened risk aversion may be driving a larger than usual wedge between risk-neutral and risk-adjusted expectations. Taking all that into account, I do not feel that the market is particularly far away from my own expectations and risk scenarios. In other words, I do not feel my reaction function and forecast is being seriously misunderstood.

Second, from a more mechanical point of view, since our forecast takes the market path as being equal to the modal expectations, we might want our inflation forecast to overshoot the target, to make the narrower point that if the current market path was a market modal expectation, we would not be entirely comfortable with that. But I think we are doing that, since our forecast shows inflation at 2.1 and 2.2 at the two and three-year horizons. I am entirely comfortable with such an implicit message.

And third, I think it is misleading to think about the fact that the point of rate lift-off has moved by three or four quarters since August as a very large move. Given how flat the curve is, small moves up and down move the implicit lift-off date by a lot. That is just geometry. But thinking about the average level of interest rates prevailing over the next three years, we are really talking about a change of 13 basis points since August, and a change of just under 30 basis points using our five day averaging conventions. Not large changes at all.

In conclusion, I am comfortable with the forecast as it stands, and with market expectations for future rate paths. I am minded to vote for no change in Bank Rate and no change in asset purchases.

Governor Carney. Do you mind if I ask a point of clarification? The second calculation you made using the averaging, I think you said 30 basis points. I just missed the…

Gertjan Vlieghe. 30 basis points is the three-year rate meaning the average, you know we focus a lot on the fact that it's flattened at the end, if you take the whole three years which is really all that matters.

Governor Carney. Yes it is 13, yes I got it.

Gertjan Vlieghe. It's 13 on day-to-day and it's 30 using the average.

Governor Carney. Thank you. So we have Jon and then Andy please.

Jon Cunliffe. Thank you very much. I'll start with my overall view and do the policy first and then explain how I got there. For me the economy is healing but it's a slow, difficult to predict, process and I've not seen enough evidence yet to convince me that the expansion has built the head of steam that would cause us to tighten policy now. In my view, the risk to output and inflation have all moved a bit to the downside since our August forecast and our ability to deal with negative shocks is uncertain. On the other hand, I do think there remain sufficient signs of strength in the economy that we are on the right path, and so I remain of the opinion that the next move in interest rates will be up. And that's the big picture view and for me it's broadly consistent with the forecast set out in the draft November Inflation Report. And as a result I see no reason to change my policy stance.

In the rest of this statement I just want to pick up some of the considerations behind that. I don't want to focus more on the yield curve, which we've discussed at great length in the forecast meetings, other than perhaps to associate myself with Jan's points about how we take account of it in the inflation outcome at the policy horizon with which I'm happy.

First, for me underlying inflationary pressures have picked up, but they remain too weak. All standard measures of unit labour costs are significantly below their pre-crisis average and below the rate necessary to return inflation to target. By end year expected annual growth rate for whole economy unit labour measures range from 1.6% on the AWE measure to 2.3% on the ONS measure, excluding the backcast. Compared to a pre-crisis average of 2.5% and 2.9% respectively, and looking at private sector measures, as Ben suggested, doesn't, to me, point to a very different picture. Annual growth in private sector unit labour costs, including the backcast, at the end of year is expected to be 2.2%, compared to a pre-crisis average of 2.8%.

And there is also, in my view, an upside risk to productivity growth relative to our forecast, which may push down further on unit labour costs in the short term. Productivity grew by 1.5% in the year to the second quarter, and we've chosen to treat some of that as cyclical and to offset it in our forecast. But as I've said before, having serially over-estimated the prospect for productivity growth in the past, we may now be making the opposite mistake, and I too took some signal from the CBI Survey data on investment that suggested a rising amount of investment was designed to increase productivity rather than to expand capacity or for renewal.

Pay growth remains modest. Whole economy pay growth was 3% in the three months to August, 0.3 percentage points below the August Inflation Report forecast. The rate of regular pay growth fell back a touch on the month and is expected to fall back to 2.5% by the end of the year due mainly to base effects. In the second half of the forecast wage growth gets back to over 4%. And that's still my central case, and pay growth has picked up significantly over the last year, but it's still a long way above the expected near-term pay growth.

One corollary of weak domestically generated inflation is continued weakness in core inflation. At 1.0% in September, ONS core inflation was 0.2 percentage points lower than forecast at the time of the August Inflation Report. It's worth noting that we would be in letter writing territory even if core inflation was the target.

Second, the balance of risks around inflation and growth are, in my view, to the downside. I'd point in particular to the risks around the international picture and around the domestic outlook.

On the international outlook, we've made a significant downward adjustment in the forecast to reflect weaker emerging market prospects. To that extent, I think we have taken on some of the downside skew from August. But the balance of international prospects remains to the downside. Indeed it is difficult to identify material upside risks. The possibility of a much more severe emerging market slowdown is still there and policy space in advanced economies is less available to meet it, particularly in the euro area and in Japan.

And on the domestic outlook, momentum has slowed since the start of the year to slightly below average historical rates of growth. In the near term the Q4 nowcast is 0.6% which is at the top of the range suggested by the staff's suite of models. Looking further ahead, the growth forecast is still heavily reliant on investment making above average contributions to growth and on a decline in the savings ratio to historic lows. These are both plausible in a central case but risks such as shocks to confidence from abroad could blow them off track. The Ernst & Young analysis of profit warnings offers one straw in the wind - profit warnings increased in 2015 Q3 to their highest third quarter level since 2008 which Ernst & Young put down to increased uncertainty about global growth and weakness in commodity prices. And the composite CIPS activity and expectation series have fallen since the middle of the year, although I think the broader picture from the surveys remains mixed. Again, on the domestic side, it's hard to think of offsetting risks to the upside.

Balancing all of this, despite a general softening in prospects, there remain sufficient signs of strength in the domestic economy to reassure me that the next move in Bank Rate will in all likelihood be up.

First, consumer confidence remains strikingly robust remaining at near historic highs.

Secondly, while we have continually revised down our short-term inflation forecast over the last year or so we can at least attribute that to identifiable external factors. External factors now account for fully 80% of the deviation of inflation from target. It's true that they have exerted more downward pressure on inflation that we originally expected but they should wash out in due course.

Third, the housing market is picking up. Approvals for house prises have picked up over 2015 and we expect that to continue. Prices are increasing at a rate at around 6%, the RICS data continue to suggest a strong near-term outlook for prices and credit conditions are relatively easy. And that may feed through to construction activity which may currently be reflecting the slowdown in house prices and approvals in the second half of last year.

Fourth, the labour market has not shown signs of weakening. The unemployment rate fell to 5.4% in the three months to August, 0.1 percentage point lower than forecast and the lowest rate since 2008. And in addition, the surveys of employment intentions remain positive and vacancies remain near record highs.

And finally, although inflation is at its lowest rate since official records began in 1997 and using the ONS model-based estimates of CPI since 1960, inflation expectations remain in my view generally anchored. They have moved down consistently since the start of 2014 and household expectations are below pre-crisis averages. But they remain within my assessment of 'anchored'. We have not seen evidence of lower inflation expectations creeping into pay, which has picked up, or suggesting that this dog has barked as loudly as we feared it might around this time last year.

Adding up those judgments: insufficient underlying inflationary pressure; downside risks; and sufficient remaining signs of strength in the domestic economy suggest my central view that the next move in rates is up is a reasonable one, but at the moment I see no reason to change the policy stance and I vote for no change in interest rates and no change in the stock of assets.

Governor Carney. Thank you, Jon. So, Andy and then Martin please.

Andrew Haldane. This month I have been reflecting on the following question: Just how SAD are the world and UK economies? In medicine, we know that SADness can take two quite distinct forms. One is Seasonal Affective Disorder. This is a temporary phenomenon, which causes a short-lived wilting of the spirits, a slowdown in activity and an aversion to risk-taking. It kicks in, at least in the Northern Hemisphere, in the autumn months, and begins to dissipate soon into the New Year. Let's call this type 1 SADness. The other SADness is Structural Anxiety Disorder, also SAD. This is a more permanent phenomenon. A durable wilting of the spirits, a slowdown in activity and an aversion to risk-taking, and it is often brought on by trauma with a slow rate of decay. That's type 2 SADness.

These psychological phenomena in humans are likely to have a counterpart in the functioning of systems that involve humans, including economic and financial systems. And indeed, it is reasonably well: performance of the stock market and the economy is statistically significantly related to the weather – type 1 SADness.

It is also well-known that the trauma of the Great Depression raised structural anxiety and acted as a lasting drag on risk-taking and activity – type 2 SADness. How does this help in making sense of the economy today?

Well there is now pretty clear evidence of the world economy having lost some momentum since around the middle of the year. And the UK economy has been no exception to that. We are about to shade down our world growth forecasts by the largest amount since the euro-area crisis.

Meanwhile monetary policy, at a global level, has eased materially in response, with some countries (such as China and Sweden) actually loosening, others (such as the euro area and Japan) threatening to do so, and others still (such as the UK and US) seeing a largish "market-induced" easing.

An important ingredient of these downgrades has been greater uncertainty about the macro-economic outlook. That is reflected, for example, in rises in various measures of uncertainty, including financial market risk premia, and some falls in measures of household and consumer confidence.

In gauging whether these responses make sense, it matters a great deal whether the economy is facing type 1 or type 2 SAD. Type 1 and this scale of response may be an over-reaction to temporary pessimism; type 2 and this response may be insufficient to capture the enduring effects of risk aversion.

There is certainly something to be said for type 1 – that is, temporary explanations of the current slowdown. Businesses and consumers may be pausing for breath until uncertainty about the global economy works its way through. So too may economic forecasters. In each of the past six years, a Seasonal Affective Disorder has descended on IMF forecasters and attendees at the Annual Meetings. Despite having been hosted in the Southern Hemisphere, this year appears to have been no exception, with WEO forecasts shifted south. If history is any guide, come the spring meetings next year and with the days lengthening, a seasonal mood swing will take hold. Optimistic sightings of 3% US growth for the year tend to coincide with sightings of the Easter Bunny. And the same may be true of households and businesses come the New Year.

Yet underlying these seasonal patterns appears to be an equally important structural one. Over the course of the past six years, global growth has persistently undershot expectations, if only slightly. We have seen steady growth in advanced economies when the news flow has been good, punctuated by periodic set-backs as anxieties have set in – China and Greece over the past six months, perhaps EMEs and fiscal policy over the next six months.

That pattern has more of the appearance of a structural anxiety than a seasonal defect, one perhaps induced by the trauma of the Great Recession. And that anxiety serves as a natural brake on longer-term spending by businesses and households at times when uncertainty picks up. That is what happened in 2011 to 2012 when euro-area uncertainty picked up and flattened growth, despite low levels of Bank Rate and extra QE. And it was the dissipation of that euro-area uncertainty, rather than the low level of Bank Rate, that then caused UK growth to spring back in 2014.

It should perhaps come as no surprise, then, that as that relief rally has faded, momentum has gently drained away from UK growth over the past two years, despite the cost of credit being unprecedentedly low and indeed having fallen further. In other words, the brake from macro-economic uncertainty has more than offset the accelerator of cheap money, even though uncertainty itself has been pretty low by historical standards.

Now it is picking up again. If the past is any guide, we should expect the uncertainty brake to be applied somewhat more forcefully and persistently than in the past. And we might also expect that to more than offset any counter-balance from a cheaper cost of credit. Why? Because it is a feature of decision-making under anxiety that you focus less on the cost of money today and more on the uncertainty around income prospects tomorrow. In this environment, I am doubtful anxious consumers will be as willing to run down their savings to the extent apparent in our forecasts; or indeed that businesses might be as willing to accumulate larger financial deficits.

These structural anxieties are apparent in the yield curve too. In financial markets, this takes the form of bi-modality. There is probably an upper tail of expected interest rates outcomes, which assume any rise in uncertainty is temporary, and the dip in growth hence fleeting.

The FOMC dot-plots, or the Reuters poll of economists, capture albeit imperfectly that “normal service resumes” interest rate path. And then there is the lower tail of expected interest rate outcomes, which assume that uncertainty is durable and the lull in growth lasting. This is perhaps captured by the modal interest rate path from the estimated yield curve, which remain close to the lower bound.

Interest rate expectations, meanwhile, could be thought of as the probability-weighted mix of this bi-modal distribution. By using information on modes and means, and assuming that bi-modal distribution, it is possible to estimate the markets’ probability of being in a Type 1 versus Type 2, or temporary versus permanent, state of anxiety.

For the US, over the past six months this probability has risen from around 40% to 50-60% at the two year horizon. For the UK, it has risen from around 25% to around 40%. In both cases, it is quite striking how high this “anxiety” probability currently is. In economists’ language, there has been a material rise in the probability markets attach to secular stagnation versus cyclical rebound. In psychologists’ language, the market attaches a higher probability to the economy being structurally rather than seasonally SAD. All of this is relevant when it comes to interpreting the forecasts we are about to publish.

The models we use are uni-modal and our forecasts themselves mean-reverting. They also assume that the impact on the economy of a lower cost of capital swamps any effects from higher uncertainty, both in impact and duration. Yet they are conditioned on a market path of rates which embody expectations - indeed, a high probability - of the economy entering a non-mean-reverting state and that macro uncertainties prove to be large and persistent. That somewhat inconsistency of treatment would tend to bias upwards estimates of demand and inflation. That is why my own subjective probability distribution for growth and inflation has a significantly negative downward skew. And it is against that backdrop that I am minded this month to leave unchanged both Bank Rate and the stock of asset purchases. Thank you.

Governor Carney. Thank you, Andy. Thank you very much. Ok so Martin, Ian, Minouche, Kristin. Martin first.

Martin Weale. Thank you, Governor. Things do not seem to have changed very much over the last month either at home or abroad. Since August we have made a marginal adjustment to UK-weighted world GDP, reflecting some news from emerging markets and a marginally weaker view of the United States. Perhaps the more important medium term change has been a reduction in the assumed underlying growth rate of emerging economies apart from China.

Our forecast includes a relatively buoyant projection for the euro area, with quarterly growth of 0.4% for the rest of this year and indeed over the next two and a half years. The near-term forecast is based on PMI figures. Nevertheless the output gap is estimated to be very material. This, with wage growth of below 2% per annum, may explain why the ECB has hinted at further stimulus being considered. Weak GDP figures from the US seem explained by weaker stock-building. Final demand grew by 0.7% during the quarter.

As we have noted, the yield curve has moved very sharply since August, and erratically in the past few days, with the first rise in Bank Rate now expected in late 2016. We discussed at length how far the move might be a consequence of term premia rather than market expectations of Bank Rate. If Bank Rate does follow the path implied by the yield curve I myself see inflation late in the forecast as a bit more buoyant than our collective projection shows.

Domestically, we have seen GDP growth of 0.5% in line with expectations and after 0.7% in Q2. It's perhaps worth noting that, excluding oil and gas extraction, the growth rate estimated by ONS was 0.5% in both Q2 and Q3 after 0.3% in Q1. So, after removing the effects of fluctuations in oil and gas output, there's no sign of things being slower in Q3. The PMIs suggest things remain stable. These Q3 data also carry good news for productivity. With overall hours worked estimated to have risen by 0.2% per quarter, the ONS figures point to productivity growth of 0.3% and, if the data are eventually revised in line with our central estimate, that gives productivity growth of 0.4%, coming after strong Q2 data. In the light of this, my inclination would be to take a view of productivity over the next year more optimistic than forecast.

But a stronger productivity outlook might well be offset by weaker than expected hours per employee. I see no sign that actual hours are rising to meet our estimate of desired hours, which indicates to me that the latter may be too high. How would this affect inflation? In principle, for a given path of demand, the split between hours and productivity on the supply side might be important. A different split might imply a different degree of labour market tightness, with consequences for inflationary pressures. I am comforted, however, by staff assurances that in practice, a plausible combination of stronger near-term productivity growth and weaker average hours would be unlikely to have a material effect on the path of inflation.

We discussed at some length how far the savings ratio might be expected to fall, as a means of validating our views on consumption and output growth. Our discussion of this reminded of the work of the Bank's former staff economist, Angus Deaton, on the link between inflation and saving. Deaton (American Economic Review, 1977) was doubtful that the only influence of inflation in raising saving came through wealth effects, but it was nevertheless helpful to be reminded that, after taking account of the accounting effects of inflation on the savings ratio in the past, and looking at saving out of disposable income, our forecast was not taking it to quite such unusual depths as superficially seemed to be the case. More pertinently, of course, the main mechanism by which monetary policy is expected to influence output is through its effect on the savings ratio. Accordingly, I do not feel very surprised if a very low Bank Rate has, as its counterpart, a very low savings ratio. Similarly, it is quite easy to see the combination of a high return on capital, over 12% per annum in the corporate sector according to the ONS, and a low Bank Rate as leading to buoyant business investment. Housing investment is also likely to be buoyant.

Fundamentally, the issue comes back to the value of R*. Has this fallen back over the past few months and if so will that persist? Sterling investment grade corporate bond yields have risen slightly since the August Report and the stock market is slightly weaker, although shares in UK-facing businesses have held their own. Perhaps financial headwinds are blowing a bit more strongly, but it's hard to see that this should on its own be a reason for changing my view that very low interest rates are eventually likely to lead to very low saving. The effects of slightly higher bank funding costs are likely in the near term to be offset by increased competition in the mortgage market.

There has been near-term weakness in inflation, with the inflation rate not expected to rise to about 1.0% until the second half of next year. Private sector regular pay has seemed more stable than late last year, rising by only 1.1% between February and August. The figure including bonuses has, at 2.9%, been much stronger but is at risk of distortion from erratic movements.

How far should these pay figures and weak inflation prospects influence policy? The pay data come after a period of considerable strength. Looking at annual changes has the virtue of smoothing at the cost of introducing a lag. While I will keep an eye on the monthly figures, I am, for the time being, comfortable following the signal from the annual rates of change. Ben argued that current nominal data do not generally provide a very helpful check on a model based forecast at a two to three year horizon, which does not surprise me. I am comfortable with the suggestion that we should pay considerable attention to private unit wage costs even if reluctant to rule bonuses completely out of the picture a priori. First, the theory of revenue-sharing firms does not suggest to me that we should. Secondly, most of the output of the revenue-sharing high bonus financial sector goes to intermediate rather than final demand. The marginal costs of firms in the consumer-facing sector may well reflect what they actually pay for financial services. On the other hand, perhaps financial services are a much smaller part of consumer-facing firms' marginal costs than they are of their average costs.

I found the discussion of time lags very helpful. If inflation were currently above target, but the yield curve were pointing to future Bank Rate rises and these were expected on their own to return it to target, I might have some difficulty in deciding how far I was willing to rely on future changes as a policy tool. But with inflation where it is and given what we have learned about lags, I do not have the same difficulty. I am expecting to vote for no change to Bank Rate and no change to our stock of assets.

Governor Carney. Thank you, Martin. So, Ian and then Minouche.

Ian McCafferty. Thank you Governor. Good morning. The issues most central to the policy decision this month are, inevitably, those we discussed at some length during the forecast round. I can accept the draft IR forecast on a "best collective judgement" basis, but in a number of critical areas, my judgement still differs a little, and those differences are critical to the policy decision. So I am going to have to test your collective patience by going through them one more time, albeit I hope briefly.

As Daniel Kahneman showed in "Thinking, Fast and Slow", it is easy to build a bearish case when forecasting, given the innate psychological characteristics of the human mind. Nor is it wrong to do so, if the evidence dictates. But is the evidence really there? The Fed appears to believe that the risks to the global outlook have diminished relative to August, though that might be just for the US, and they might be wrong. We have moved in the other direction. Are we right to do so?

To my mind, the recent data news remains equivocal, and the September survey data in particular will have been affected by mood as much as fact. Overall, I am not convinced that the evidence fully supports the shift in the numbers - and, in particular, what appears to be the tone of the narrative in our November forecast.

On the international front, it is clear that some EMEs are weakening sharply, but I agree with Kristin's point about the need for differentiation. It is those EMEs exposed to particular commodity prices and with specific domestic problems that are faring worst. While some revision in EME growth relative to August is warranted, it is not clear to me that this is yet more than cyclical, and is more likely to affect 2016 than the full 3 years of the forecast. That EME annual growth forecasts for the last three years have disappointed suggests an underestimate of the importance of the credit and commodity cycles for EMEs rather than a reassessment of their underlying potential.

But, of course, for our forecast, the pace of non-China EME growth makes only small differences to our forecasts, at least through direct trade channels, so the key issue is the extent to which slower growth in EMEs is feeding through into the advanced economies. Those of negative bent will point to the weakening of the PMI surveys in Europe in recent months as well as the most recent US GDP data to suggest that a slower trajectory is already underway. While some loss of momentum through Q3 and Q4 is likely after the negative shock to sentiment of August, we still need to determine whether this is a pause, or the first signs of a more marked slowdown. At this stage it is clearly impossible to be definitive, but it is worth reflecting on how such shocks tend to permeate the business sector, and what previous episodes might tell us.

The first reaction across the corporate sector to the surprise August slump in equities and the increased concerns about China will have been what I once described as "a temporary paralysis in decision making". Faced with sudden increased uncertainty, businesses put decisions on hold until the true extent and nature of the shock becomes clearer. Investment project sign-offs are postponed, orders to suppliers are held back and inventory levels are run down, just in case. This sort of behaviour is not uncommon – it happened in response to the 1987 stock market upheavals, to 9/11 and in a number of other difficult-to-interpret shocks over the past forty years.

This behaviour is consistent with the data we have: the initial surveys, particularly for manufacturing (where such behaviour is easier than for most services companies), pointed to softening levels of confidence and a rise in uncertainty, weaker order flows and some destocking. But the latest PMIs suggest a bounce back. The early data for Q3 GDP in the US was held back by weaker inventories, while that in the UK was characterised by weakness in manufacturing. To that extent, the slowing in manufacturing we were starting to see in the summer resulting from stronger sterling has been somewhat amplified.

Such shocks therefore lead to a softer period in activity, usually lasting a couple of quarters, but do not necessarily signal the start of a bigger change in direction, unless other, often policy related, factors are also involved. Already, UK equities are recovering, and fears of an imminent disruptive slowdown in China have been calmed by the latest data. Other UK data for the domestic economy, particularly for consumer spending and housing, continue to suggest underlying strength, and this is also likely to help calm business uncertainties.

In conclusion, while the news justifies a slightly softer GDP profile through the winter, a greater adjustment than that in terms of growth in 2016 and 2017 is not, in my view, yet fully merited.

As a consequence, I do not believe we should be fully offsetting the impact on medium term GDP of the recent move in the yield curve. While the move in the curve probably contains some reassessment of the central outlook, a good deal is the result of higher uncertainty and a downside risk scenario – causing a jump in what Andy termed last week the "macro risk premium".

So, while a downward skew to GDP is easily justified, I would have preferred a slightly stronger central GDP path than in August, with the additional stimulus from the curve more than offsetting the other adjustments.

Now while I can accept the forecast numbers, I would caution against too negative a tone in presenting the IR, as an over-gloomy tone risks becoming self-fulfilling in a period in which sentiment remains somewhat febrile.

A slightly stronger central growth forecast would yield a slightly greater inflation overshoot into year three than the 2.2% pencilled in. When I combine this with my continued concerns about the trend in slack and the likely response of wages over next couple of years, I think there are some upside risks to inflation at the two-year horizon as well. The latest data on wages are inconclusive in a quiet period of the year, pay-wise, but the employment and unemployment data, combined with that on skill shortages and recruitment difficulties still point to a tightening labour market. And unless productivity growth is faster than I expect, there is, for me, an upside risk to unit wage costs and hence our inflation profile.

While on the subject, I thought Ben's discussion of looking at inflation pressures through the lens of the cost pipeline more helpful at the current juncture than our considerations about slack. And in my view, we should focus on this approach going forward, and reduce our emphasis on slack. I also agreed with Ben's breakdown of the most relevant measure of unit wage costs, with one exception. At least outside the City, bonuses are becoming less distinguishable from more regular pay, and should not be ignored when looking at pay trends, although their volatility does make interpretation difficult.

To sum up, I am reluctant to ratify the level of the curve on which the forecast is conditioned, which leaves lift off as far off as the second quarter of 2017. I can currently see two scenarios for the path for Bank Rate: either the economy continues on the current course, requiring us to start raising rates much earlier than that, or the world economy really does go pear shaped, such that the option of more stimulus becomes a serious consideration later on. But for now, I see the latter only as a small downside risk.

As such, I expect to continue to vote for a 25 basis point increase in Bank Rate, while leaving the stock of assets unchanged. For me, the outlook for the economy, and for inflation, continue to be solid enough to justify a Bank Rate of 0.75%, although I should state that I do not see such a move as the start of a series of tightenings, given my keenness for gradualism.

Finally, I agree with the outcome of our discussion about the policy lag. It is not clear to me that the analysis is yet sufficient to justify a change from 18 to 24 months, and at a time of high uncertainty about our reaction function, the communications difficulties alone suggest that we should leave well alone.

Governor Carney. Very good. Thank you, Ian. Minouche please.

Nemat Shafik. Well, unlike Andy who started and thought a lot about sadness this month, I started off thinking about humour. And my eye was struck by a full page add in the Financial Times for something called “Kilkenomics” which has billed itself as “Davos with jokes”. It is an annual event for alternative thinking about economics which mixes economics with comedy. It has sessions like “Hipsternomics” and “The Great Fall of China.” But it did make me think that considering alternatives was a healthy way to test one's own thinking. So, my central expectation remains that the real and nominal economy will continue to recover such that a tightening of policy will be appropriate in the first half of next year, but I would like to use my statement today to consider what the most likely alternatives are off that central expectation.

Let me start with the world economy, where my central expectation is that the world economy will continue around its current level, and even pick up a little in the second half of our forecast. But the risks seem tilted to the downside, such that the most likely alternative outcome is one in which emerging market policymakers fail to manage the transition to slower potential output, and less commodity-driven growth.

We saw in the Key Issue meeting that slower growth in emerging markets can have an impact on UK GDP through trade channels. And if there were a severe downturn to materialise we need to factor in some additional deterioration in domestic credit conditions given the exposure of our banks to vulnerable EMEs, and the potential for a period of lengthy turbulence in financial markets.

Our colleagues at the Fed and the ECB have attached more weight to the slowdown in EMEs than we have, although the recent FOMC statement reversed this somewhat. Their likely actions in the months ahead will go in opposite directions, with the Fed probably tightening and the ECB probably loosening. The UK will once again find itself in the middle – with our exchange rate and yield curve pulled in different directions. On balance I think the main impact of global developments, however, is to add to the uncertainty that we will face.

On the domestic front, my central case is that the mild slowdown we are now witnessing is not disproportionate to the effects of a slowing world economy and a fading boost from lower energy prices. Business surveys point to only a mild slowdown, consumer confidence remains robust, and financial conditions are easy. So there is not an a priori reason to think that private domestic demand will do anything other than continue growing, and that will be sufficient to close the remaining degree of slack. Trend growth is no bad thing.

But I note that this would actually be a change from recent experience: this Inflation Report will be the fourth in a row in which we have judged the level of slack in the economy to be about ½%, the magical 0.5 that Ben always cites as the number to go to when in doubt. But that will mean growth has not been sufficient to narrow the remaining degree of slack over the past year – we have instead moved sideways.

On that note, I was struck by the evaluation of how our forecast from a year ago has performed. Despite lower energy prices, and stronger productivity growth and a significantly lower yield curve, GDP growth turned out a little weaker than we had expected. Granted there has been a slowdown in world activity, but net trade has actually surprised on the upside: it is investment by businesses and (relative to the unexpected strength of real incomes) consumption by households that has disappointed. There are parallels here with the industry breakdowns of GDP, where Venetia showed us that - contrary to what one might have expected - the slowdown in services and manufacturing has not been led by the most export intensive sectors.

So if I had to pick an alternative to my central case of continued strength in domestic demand being sufficient to close the remaining degree of slack, the most likely would seem to be that we will witness a broader slowing of domestic demand, and that the degree of slack will not narrow as quickly as we hope.

As for inflation, the data tells us that around four fifths of the deviation of inflation from target is attributable to food, energy and other goods, which provides corroborative evidence for believing that inflation will rebound over the next year as base effects drop out, and continue to increase thereafter as domestic cost pressures continue to build.

But the continued undershoot of our inflation forecasts is proving more and more difficult to ignore – the error for 2015 Q3 was the largest one-year ahead downside error since the MPC started targeting CPI inflation. And although domestically generated inflation has been relatively stable, all DGI measures are below their pre-crisis averages, as Kristin reminded us of, which is surprising given the narrowing of slack over recent years. Moreover, I am troubled by the fact that despite a resumption in productivity growth, wage growth seems to have plateaued, and is now expected to decline to 2½% over the coming months.

So if I had to guess which way my forecast of a rebound in headline inflation might go wrong over the coming years, I'm afraid to say that it seems most likely to be on the downside.

Finally, let me say a few words about the yield curve. My view is that the path for Bank Rate implied by the yield curve – in which lift off is in 2016 Q4 and Bank Rate rises by 8 basis points thereafter is too flat. If my central expectations for activity and inflation prove right, I would expect to have voted for an increase before then, and thereafter to move Bank Rate more quickly toward a level from which it can be materially cut.

We had a good discussion of the level of the yield curve in our deliberation meeting, and I think we agreed there were reasons to think that the yield curve is not a fair reflection of the market's best expectation for Bank Rate either, including the fact that the market curve is a mean expectation with some weight on downside risks from the world, and that - at times of uncertainty - risk premia will tend to push the yield on safe assets lower than that that would be warranted by expectations alone. That is my central case, and I think many of your statements this morning concur with that.

But in the spirit of thinking about alternatives, I note that in the period since the recovery began in 2009, the OIS curve has actually tended to predict a higher path for overnight rates than actual outturns. So, based on past performance it would be churlish to assume the yield curve contains no information about the outlook for the economy.

While the organisers of Kilkenomics, who are hoping that their alternative take on economics will be comic, I'm afraid my alternative takes on what we are seeing in the real economy and financial markets have turned out a bit more sombre. My central expectation remains that we will have seen enough to begin tightening monetary policy in the first half of next year, but I will be hoping to see confirmation in the meantime that my more sombre alternative scenarios are unlikely to materialise.

And for this month I intend to vote for no change in Bank Rate and no change in the stock of purchased assets.

Governor Carney. Very good. I noticed that the headliners of Kilkenomics are Yanis Varoufakis and Martin Wolf, who are the sort of Laurel and Hardy of our profession. Should be rip-roaring! OK, Kristin you have a chance to talk sad, talk Kilkenomics, talk to us all so.

Kristin Forbes. Usually I have no trouble crafting a theme and summarizing the latest economic developments. This month has been more difficult. I've written three drafts based on three completely different frameworks. But the process has been informative, so let me describe what I learned before turning to news and policy implications.

I tried something unprecedented this month—drafting my policy statement before the Pre-MPC meeting. That draft has been completely scrapped. Lesson learned: procrastination can be efficient. But why it was scrapped is insightful. What I drafted was a close look at recent data and whether it altered my views on the outlook for monetary policy. My analysis was strikingly similar to what was presented at Pre-MPC. I scrapped that statement, not because I missed anything or because the subsequent discussion changed my views, but rather because it would have wasted your time to repeat what you'd heard.

I attempted my second draft after reading the IR and seeing the latest iteration of our forecast. As I expressed Thursday, although I share concerns about downside risks, I believe our forecast is too negative. In response, I drafted my statement highlighting the opposite view. Granted, this scenario did not involve a return to mid-2000 growth rates, but it was not hard to make a case that inflation could accelerate faster than expected, especially if conditioned on the current yield curve. It was tempting to make that case today, mainly in the hopes that presenting an extreme view for one argument might shift the average sentiment in this room. But, an entirely optimistic take on the global economy is not an accurate reading of the recent data. Cherry-picking only data to make a certain point is not what we should be doing.

Which then leads to draft three. Since much of my time is already exhausted, I'll make broad points in the context of our current forecast. See Pre-MPC material for my data summary.

First, some components of our new forecast make sense based on recent data. A softer path for investment is realistic given the weakness in global manufacturing, predictions from our suite of models, and uncertainty regarding EU membership and the global outlook. A softer short-term inflation forecast also makes sense given lower oil prices. Even though some DGI measures—especially those related to unit wage costs—are picking up and the effect of sterling's appreciation is beginning to wane, there is still not enough acceleration in other measures of domestic inflation to counteract the continued drags from global prices. The fact that 88% of the deviation of inflation from target can be explained by lower prices for energy, food, and clothing and footwear highlights the challenges.

Second, other parts of the forecast are not as closely aligned to my views, but make sense given the constraints of our framework and as the MPC's "best collective judgement". For example, the forecast for productivity growth seems too low, and for desired hours seems too high, given data trends. Granted, we are constrained by our goal not to revise our supply assumptions after each data release, but these divergences suggest we may need to allow some flexibility to make revisions more than annually if a series of data raises challenges.

Another component of the forecast I'm not entirely comfortable with is the sharp downward revisions to the global outlook. Emerging markets are certainly weaker, but the outlook for the countries that have the strongest effects on the UK have held up well. Euro-area Q3 growth is expected to remain stable at 0.4% quarter over quarter, more than double its average over the last three years. US GDP growth was broadly as expected at 1.5%--which sounds low but includes a 1.4% drag from inventory accumulation combined with a healthy 3.2% growth in private domestic demand. Our economic surprise index is sharply positive for the euro area, and slightly positive for the US, since August.

Even China's GDP growth was about as expected, and although the usual data scepticism is warranted, corroborating evidence suggests it is probably not far off. A combination of policy support and strength in domestic consumption and services is partially compensating for the contraction in manufacturing, exports and investment. For example, September data for retail spending and construction were stronger than expected, sales of cellphones and movie tickets have been robust, and measures of consumer confidence (such as Westpac, NBS and Bankcard) have been improving. The Chinese consumer seems unfazed and is not retrenching. JPMorgan has created a useful new index to better track service growth and assess the relative weight of these counteracting sectoral effects. The index shows that rebalancing is occurring to such an extent that GDP growth has only moderately slowed and is close to reported. Although there are legitimate concerns about medium term sustainability, especially if not combined with financial reforms, a major negative surprise in China that derails the UK recovery seems to be only a risk in the short term and not a baseline.

News for other emerging markets is mixed. Countries reliant on commodity exports and vulnerable to shifts in capital flows are facing major challenges, especially if combined with domestic vulnerabilities (ie, Brazil, Russia). But the outlook for non-commodity exporters is only slightly softer. Growth expectations for emerging markets immediately after the crisis were too optimistic. For example, IMF forecasts for EMs made in 2010 predicted average annual growth of about 7% from 2010 through 2015—equivalent to growth from 2002 to 2008, which was the fastest for a window of this length since the IMF started tracking this group in 1980. But just because growth will not match the record rates set during an unprecedented period fuelled by growth in China and a commodity boom does not mean that today's negative sentiment is justified over the medium to longer term. This is the perennial challenge for forecasting—accentuated in EMs—of separating the cycle from the trend. I look forward to more analysis of long-term growth prospects in EMs.

My final topic has a more substantive effect on the forecast—and is what I'm least comfortable with--treating recent movements in the yield curve. The current yield curve would normally imply a sharp pickup in growth and inflation, substantially above our forecast. I doubt this will occur, mainly because I don't believe monetary policy will follow the path implied in the curve. I appreciate the predicament of producing a realistic forecast based on an unrealistic yield curve, and thereby trying to find some fix. Who knows—maybe the current fix, which lowers the impact of the yield curve compared to our traditional multipliers, will make sense to adopt systematically. But it currently feels very ad hoc and not justified by the type of analysis that should support such a major change. This type of adjustment should be assessed outside the forecast round to better evaluate its merits and validity, especially implications for forecasts over a longer period, rather than in the context of shaping today's. I am worried about how we will unwind this fix, or make similar judgements in the future, such as if US rates increase in December and our yield curve bounces back.

The bottom line: I've found this round's forecast less useful for thinking about the appropriate path for monetary policy. So what is useful? Back to basics. Recent data has been a bit softer as a whole, but not by enough to change my underlying outlook for monetary policy. The global economy has slowed, and there are noteworthy downside risks, but the UK-weighted global economy is holding up. The continued solid (but not spectacular) UK recovery, moderate tightening of the labour market, continued firming in wage costs, and growing evidence of labour shortages, suggest tighter monetary policy will be needed in the not-too-distant future. Further declines in oil prices have played an important role in pushing back the timing of when this should occur, but not undermined my basic outlook. Therefore I will continue to vote for no change this month.

Governor Carney. Thank you, Kristin. Thank you everyone. So, this month we're publishing our fourth open letter on the downside. And when you have one-off base effects being responsible for pushing inflation below target, such letters tend to come in fours. That would be the idea. However, I think we can say with some confidence that there are more letters in the pipeline.

Our forecast for annual inflation exceeding 1% only occurs at present by the fourth quarter of next year. So on the face of it, such persistence is inconsistent with a simple, one-off base-effects narrative and I'm just going to concentrate on this point, I'm not going to repeat the yield curve and other arguments that others have made much more eloquently than I could.

Now, of course, our original narrative, back in February, also acknowledged a drag from slack that would be revealed once these one-off price level effects had dissipated. But I'm going to suggest that it may be useful for our narrative to shift a little towards one which has greater emphasis on persistence, a little more emphasis on persistence. Certainly compared to when we started letter writing in February, the return to inflation target is now expected to be more gradual over the first year of the forecast – it is actually quite marked. In calendar time, by Q3 of next year we now expect the inflation rate to be some 0.8 percentage points lower than we had expected in February, and obviously we still expect it to be less than 1%. Now, the main reason for that is further downward contributions obviously from energy prices, which again, on the face of it, is a bit strange since the sterling price of oil isn't that far south of what it was at the turn of the year. However, as you know, oil and gas future curves have fallen further since February and now are about 15% lower than they had expected to be, and I would add just as an aside, importantly I think and this is in the Inflation Report, whereas the initial price shock was largely ascribed to supply news, evidence has accumulated certainly of slowing global demand, lessening the net expansionary impact of recent developments. Now, some of these developments should appear relatively quickly in retail petrol prices. But utilities are expected to make further cuts to prices next year, a delay reflecting the time it takes for hedging contracts to roll off and that 15% downside news in gas futures relative to February.

All of that imparts some persistence to the effects of lower wholesale prices on consumer prices, meaning an additional drag of about 20 basis points to inflation in 2017. And, as you can gather, I'm suggesting a somewhat clear distinction we've sometimes drawn between base effects on annual inflation arising from changes in flexible prices of goods, particularly commodities and more Keynesian persistent effects on inflation, resulting from nominal rigidities. In other words a fraction of the energy price effect is similar in character at least, to that from slack and to other imported goods prices that are subject to retailers' staggered pricing decisions. And obviously we want to avoid a category mistake by not recognising that.

The second factor behind a more gradual return to target is news from sterling import prices, and again I'm measuring relative to February. Our conditioning assumption now incorporates a further 4% appreciation of sterling than we'd expected then; on the staff's inflation decomposition this shows up as an additional drag on annual inflation of 10 basis points on average over the next two years with the effects concentrated in the near term given our pass through work.

So these two factors explain the bulk of the additional shortfall in the inflation projection in November compared to February. There is also a small additional contribution from slack with an output gap that's 0.3 percentage points wider at this quarter, and 0.2 percentage wider next quarter imparting about 10 basis point drag over the next few quarters. I sort of join Jan and Jon and others in noting that suspected in our supply conventions we risk undercooking our productivity forecast, at least in the near term, although I take Martin's and Kristin's caution on the average hours so there may be some element of this coming out in the wash; but we'll have to watch this quite closely. And it is, by the way, going to create a communication challenge for us coming out of this forecast to have a lower deck for productivity given the acceleration in productivity. But there'll be no shortage of communication challenges. I'm working up to try and lessen one of them, let's put it that way.

So turning to monetary strategy, what this sort of balance between base and persistence suggests is that the effects of shocks currently hitting this economy will take longer to die out. It also means, of course, that their influence on the economy is more amenable to the influence of monetary policy. In other words, just because something's persistent is not the same as saying it's immutable or exogenous. And if anything it suggests less weight should be placed on instrument instability in considering the appropriate balance between the inflation target, the volatility of output and employment, and the volatility of Bank Rate itself.

That said, the move away from base effects also normalises the appropriate horizon for monetary policy to return inflation to target. To be clear, the language we've been using within two years suggested base effects, or predominance of base effects and the absence of a monetary policy trade-off between inflation and output or employment, and moving as it's in the draft of the letters you've all seen, moving towards a return to target in around or even beyond two years, it's not designed as beyond but around two years in the draft, would reflect the more conventional monetary policy strategy choice that we face, emphasising persistent and rigidities.

Now our November projections are clearly consistent with this aspiration. As you know, inflation at 2.1% at year two as the mode and 2% on the mean. Taking a little longer to return is consistent with a firmer tightening bias, ceteris paribus, which I view to be helpful on the margin to ensure that our reliance on a sharp fall in household savings and a reacceleration of housing doesn't overshoot. This is particularly relevant I think given that recent progress, at least in my judgement, recent progress towards reflation has been mixed and I'll just finish by summarising that.

Despite the substantial downward revision to our world forecast and it is the biggest downward revision, as you know, since the euro crisis, the risks to the world do seem, at least to me, slightly skewed to the downside. I do think a probability of bigger accidents remain in major emerging markets, Brazil and China specifically, and there is the possibility of further euro-area easing appreciating sterling further.

Domestically, there has been greater slowdown in private domestic demand than we had been expecting by about 20 basis points over the second half of this year. I agree with Jan that fiscal drag is yet to be tested and it is starting, and I for one view that as part of the downside risk, although I won't say that publicly. I won't go through the CIPS. I would set against these sort of signs of softening momentum the prospect of renewed vigour in housing and the collateral channels that could also arise from that for consumption given accommodative credit conditions. I join others in underscoring strong real income growth, still buoyant consumer confidence and firm investment intentions all supporting domestic demand growth. So overall, my sense is that the short term prospects for growth are to track but not exceed potential growth so we may continue to move a bit sideways, as Minouche was saying. But those risks are broadly balanced further out in the forecast.

Finishing on the cost side. The balance of upside news on productivity and slightly firmer wages – various ways to measure it. I would say a mixed picture on firm costs given what we had expected in February. I would note, I do watch core and I'll just point out that, since April of 2013, 50% of the time core has surprised on the downside. A quarter it's been in line and then a quarter of the time on the upside. There is a sense of greater persistence in low inflation basically than we had expected. I think we should take some signal to that. Overall, risk to cost pressures again seem manageable, maybe mildly to the downside. I don't feel we've made a tremendous amount of progress, basically, in the course of the last quarter.

But to conclude, while the year has not yet turned, the short-term decision, at least to me, doesn't appear all that difficult. Disagreeing with the modal market curve doesn't require an accelerated tightening, particularly given the halting progress towards increased price pressures relative to our prior expectations. But by using a combination of our forecast of an overshoot on modal inflation at year two and more notably at year three, and by profiling some of these persistent factors, some of the language in the IR downplays the persistence a little too much for my liking. And tweaking our trade-off, I think we can balance what could be interpreted as a dovish message – at least that would be my preference, and so that clarity of the tightening bias because while I expect to vote for no change, no change at our decision meeting, I do think the next move is up and will come into maybe if not sharper relief for the turn of the year, in the first half of the year – I will walk away from that expression in a couple of days.

Ok, so that's good. We will reconvene on Wednesday. I know we have to go through forecast and everything, but we'll reconvene on Wednesday to take stock and have the official vote. What I took was that we had nine voting intentions for no change in asset purchases. Eight votes for no change in Bank Rate and Ian likely to vote for a 25 basis point increase in Bank Rate. OK, good.

A meeting of the Monetary Policy Committee was held on Wednesday 4 November 2015. The following members of the Committee were present:

Mark Carney, Governor
Ben Broadbent, Deputy Governor, Monetary Policy
Jon Cunliffe, Deputy Governor, Financial Stability
Nemat Shafik, Deputy Governor, Markets and Banking
Kristin Forbes, External Member
Andrew Haldane, Chief Economist
Ian McCafferty, External Member
Gertjan Vlieghe, External Member
Martin Weale, External Member

Dave Ramsden was present as the Treasury representative

The following members of staff were present:

Gareth Ramsay, Director, Monetary Analysis
Fergal Shortall, MPC Secretariat
Simon Hayes, MPC Secretariat
Melissa Davey, Editor of Inflation Report

Transcript of the Monetary Policy Committee Meeting on

Wednesday 4 November 2015

Governor Carney. OK, good afternoon everyone. Welcome to the Decision meeting for November. What I suggest we do is that we start with an update on recent market developments because obviously there have been fair size moves in the last several days. So I'll ask Minouche to give an update on recent market developments, and then Andy to run through some of the recent data before we turn to our decisions. Minouche, when you are ready.

> **Nemat Shafik.** I will give an update. We circulated the tables. So, obviously, the biggest recent market development is the change in the yield curve since the forecast, and you can see that in the money market instantaneous rates which you see in the middle of the table, and those moves have been very large. I think other than that, that has been the biggest move to report. I don't have much more than that.

Governor Carney. And the only other thing to flag is that the sterling ERI has come back, the exchange rate has come back a fair bit, so we've had a bit of a round trip. In fact, we now have the ERI back to effectively August levels. And, as you note, sharper moves across the curve. Not unwinding everything, but consistent with the moves we had identified a few days ago. So, thanks. Andy, recent data.

> **Andrew Haldane**. Yes, so maybe one or two bits and bobs. On the international side we have had the slew of PMIs continued. In the euro area we had the final estimate for October, which is up a bit from September and just a little bit weaker than the earlier flash estimate that we had seen. In China we had a couple of PMI indices from there, which actually pointed in opposing directions. So doesn't obviously clarify the position very much. And then we've had some from across the emerging markets, non-China emerging market community as well, which is pretty much a mixed bag with continued falls in some, for example Brazil and India, but some increases elsewhere - Russia and Turkey. So, overall, nothing there that fundamentally alters our projections for the world.
>
> Turning to the UK, we now have the full breakdown of the PMIs for October. You will recall the composite was up a bit, and the expectations series was, broadly speaking, flat. Within the components of the output series, manufacturing up sharply, services up too and construction down just a little bit. Within the expectations series manufacturing up sharply, services actually down a little bit, output flattish. We have had the new car registrations data for October, which fell by just over 4%. And we have had the Halifax house price index, also for October, which rose pretty sharply, just over 1%, having fallen by a bit less than 1% last month. If anything that means the overall indices are a touch stronger than we'd thought. That's it, thank you.

Governor Carney. Any questions about any of that? No, OK. So let's turn to the decision. We had an extensive discussion on Monday and so I'll put to the Committee the proposition that Bank Rate should be maintained at 0.5% and that the Bank of England should maintain the stock of purchased assets financed by the issuance of central bank reserves at 375 billion sterling. So I'll start with you Ben.

> **Ben Broadbent**. I reaffirm my vote for both no change in either Bank Rate or the APF.

Governor Carney. Thank you. Jan.

> **Gertjan Vlieghe**. No change to Bank Rate and no change in asset purchases.

Governor Carney. Jon.

> **Jon Cunliffe**. No change in Bank Rate, no change in the stock of purchased assets.

Governor Carney. Andy.

Andrew Haldane. No change in Bank Rate and no change in the stock of purchased assets.

Governor Carney. Martin.

Martin Weale. No change in Bank Rate and no change in our asset holding.

Governor Carney. Ian, please.

Ian McCafferty. I vote against the first proposition, a rise of 25 basis points in Bank Rate but I vote for the second, no change in asset purchases.

Governor Carney. Minouche.

Nemat Shafik. No change in Bank Rate, no change in asset purchases.

Governor Carney. Kristin.

Kristin Forbes. No change in Bank Rate, no change in asset purchases.

Governor Carney. And I vote for no change in Bank Rate and no change in asset purchases, making the vote 8 to 1 to support the proposition for no change in Bank Rate with Ian McCafferty voting for a 25 basis point increase. And 9 votes to 0 for no change in the stock of purchased assets. So with that, unless anyone has any other business, I'll close this part of the meeting and we will go to work on the minutes.