BANK OF ENGLAND

Inflation Report presentation

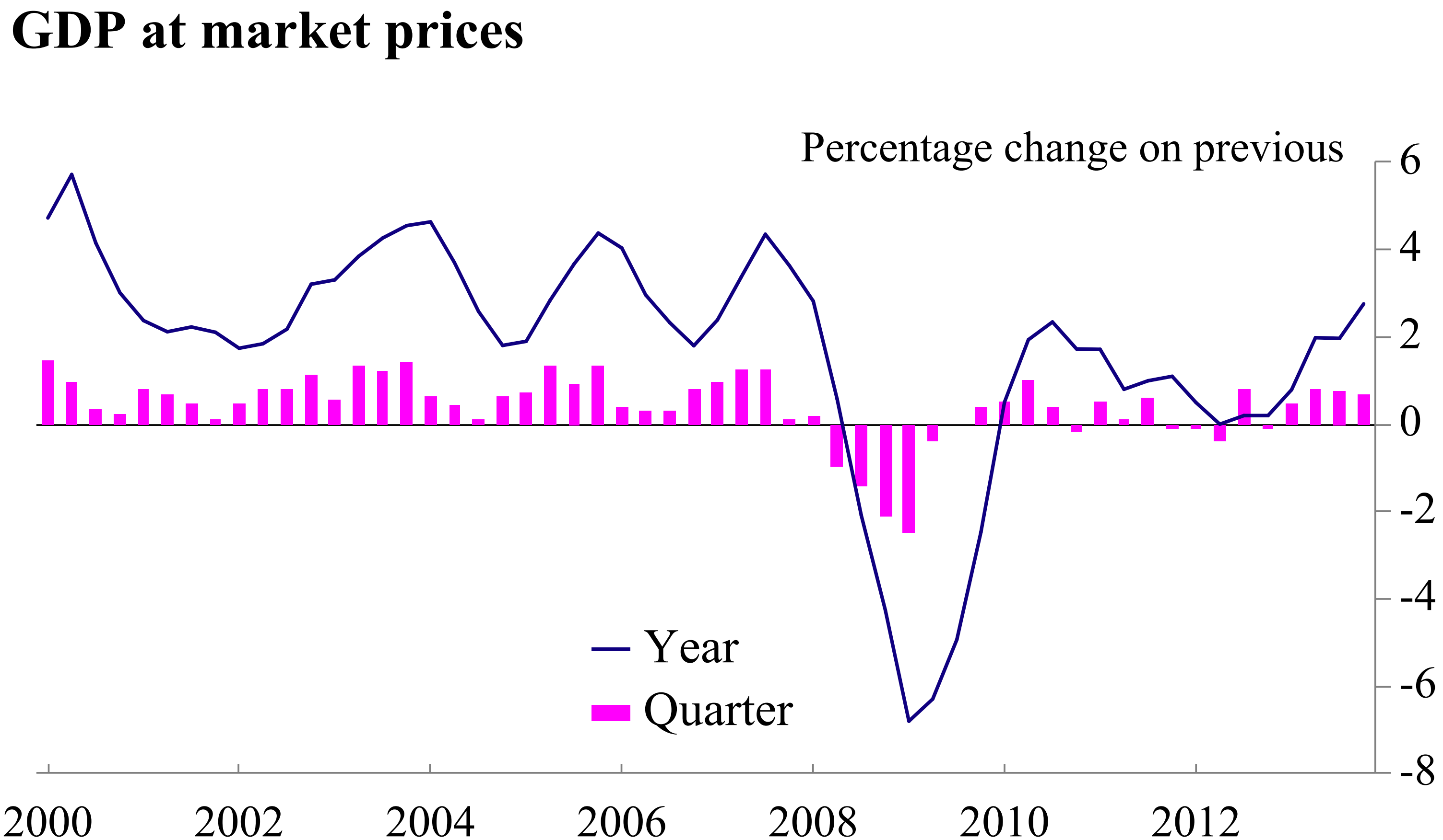
February 2014

Stephen Collins

Agent

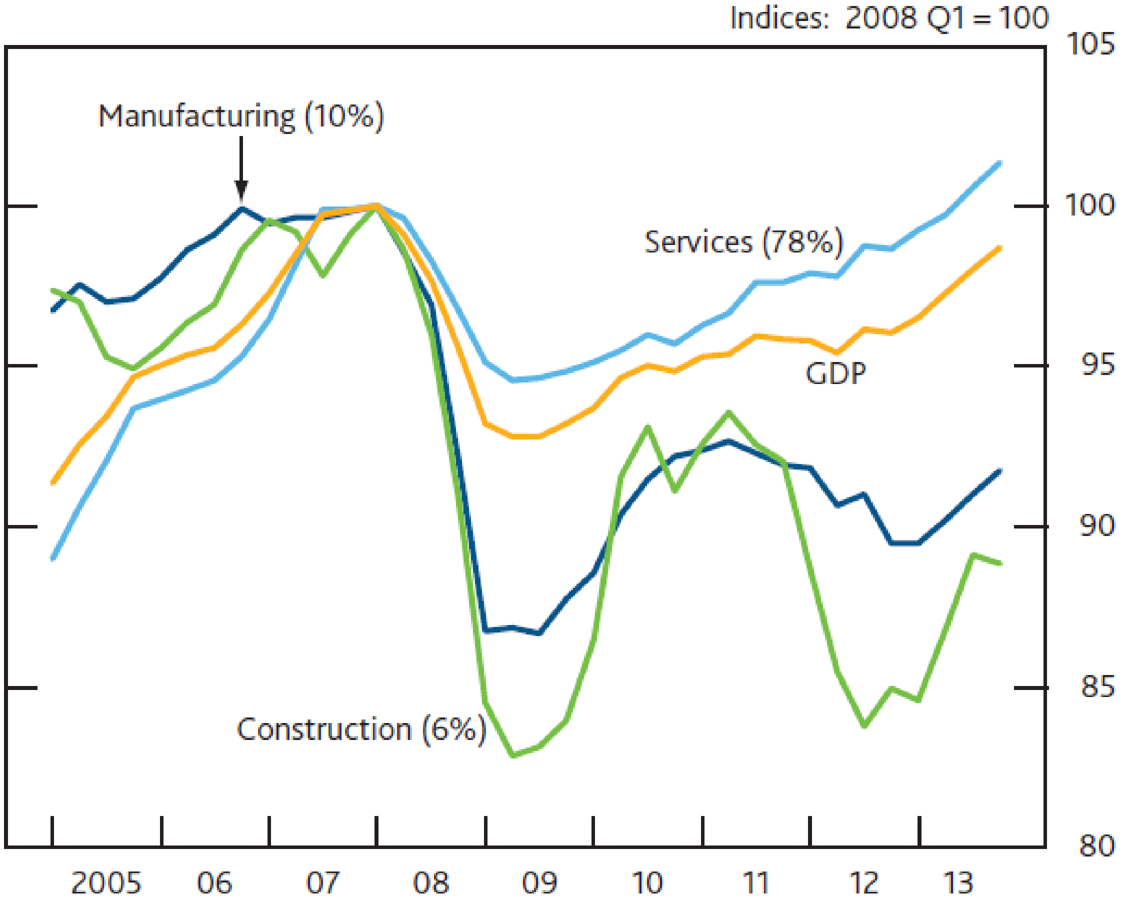
Agency for South West England

UK economic growth



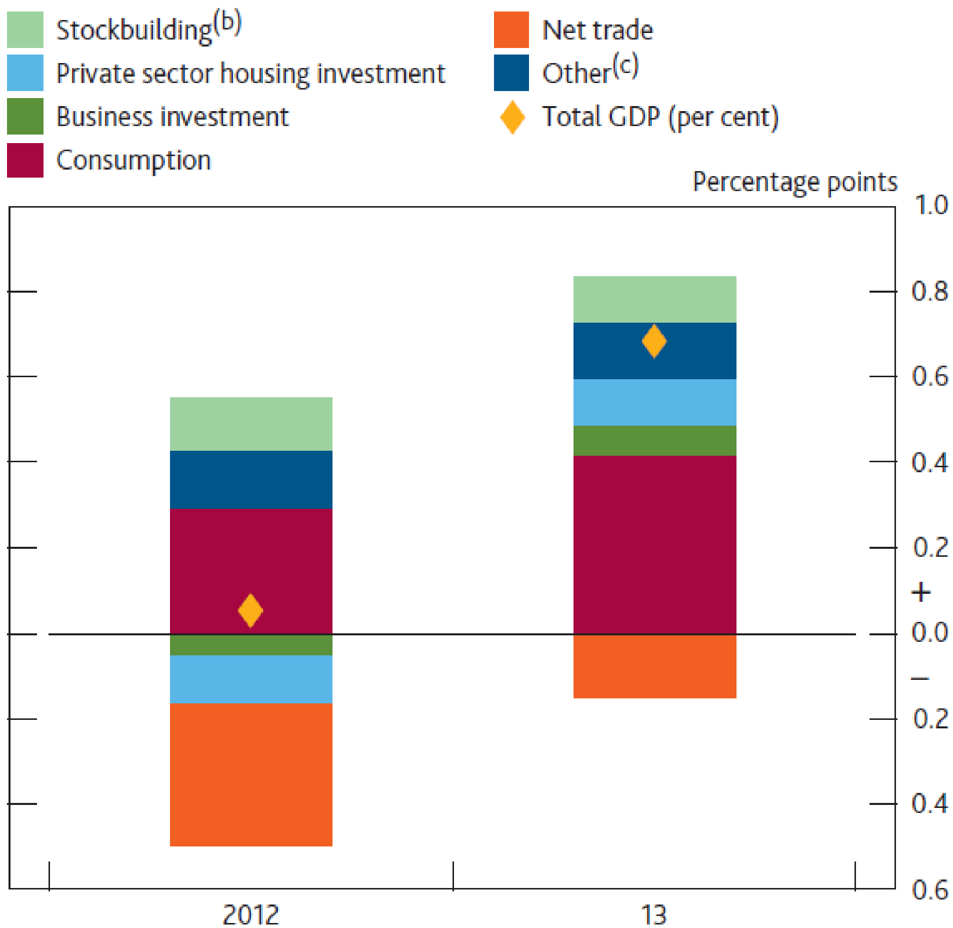
2013: 0.5%, 0.8%, 0.8%, 0.7% QoQ, +1.9% YoY

GDP and sectoral output

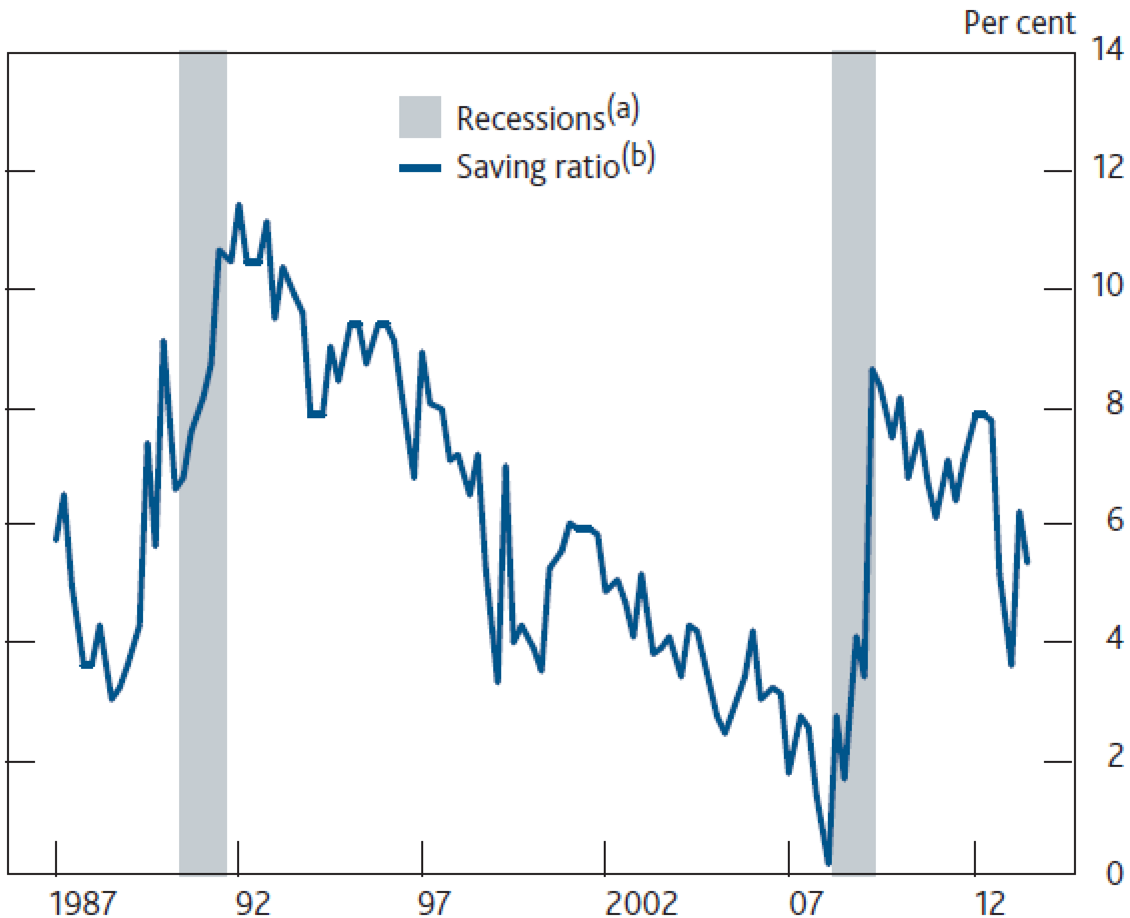


DEMAND

Contributions to average quarterly GDP growth



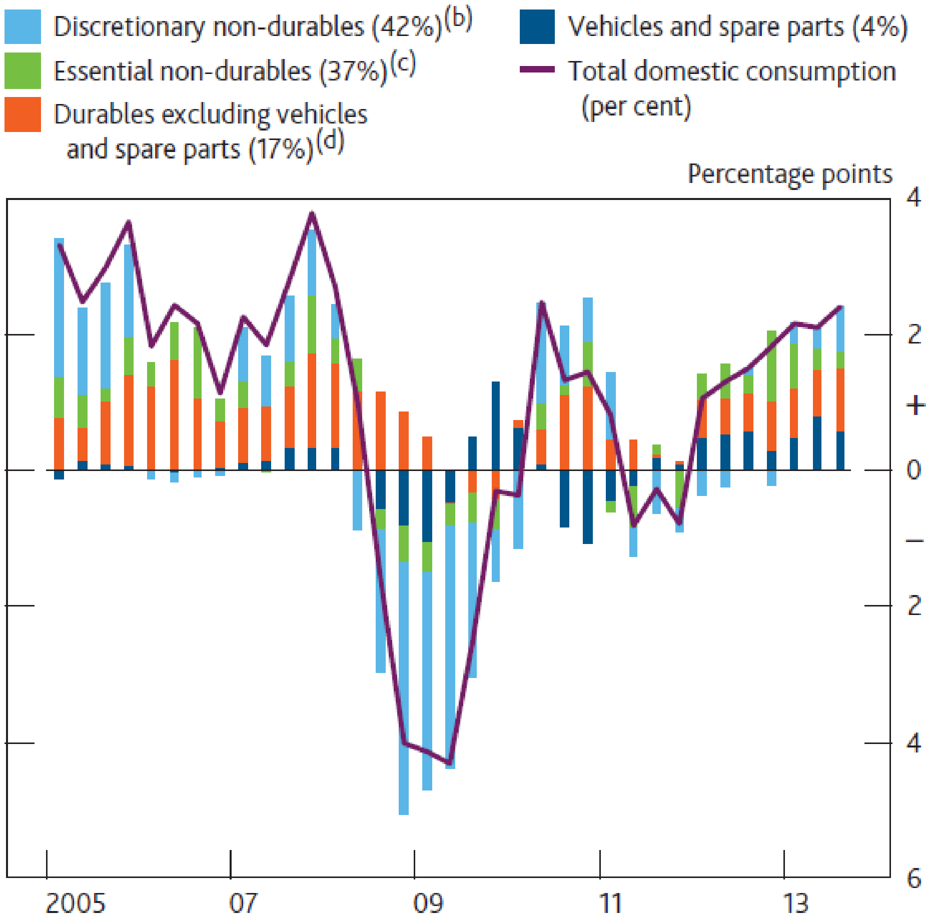
Household saving ratio



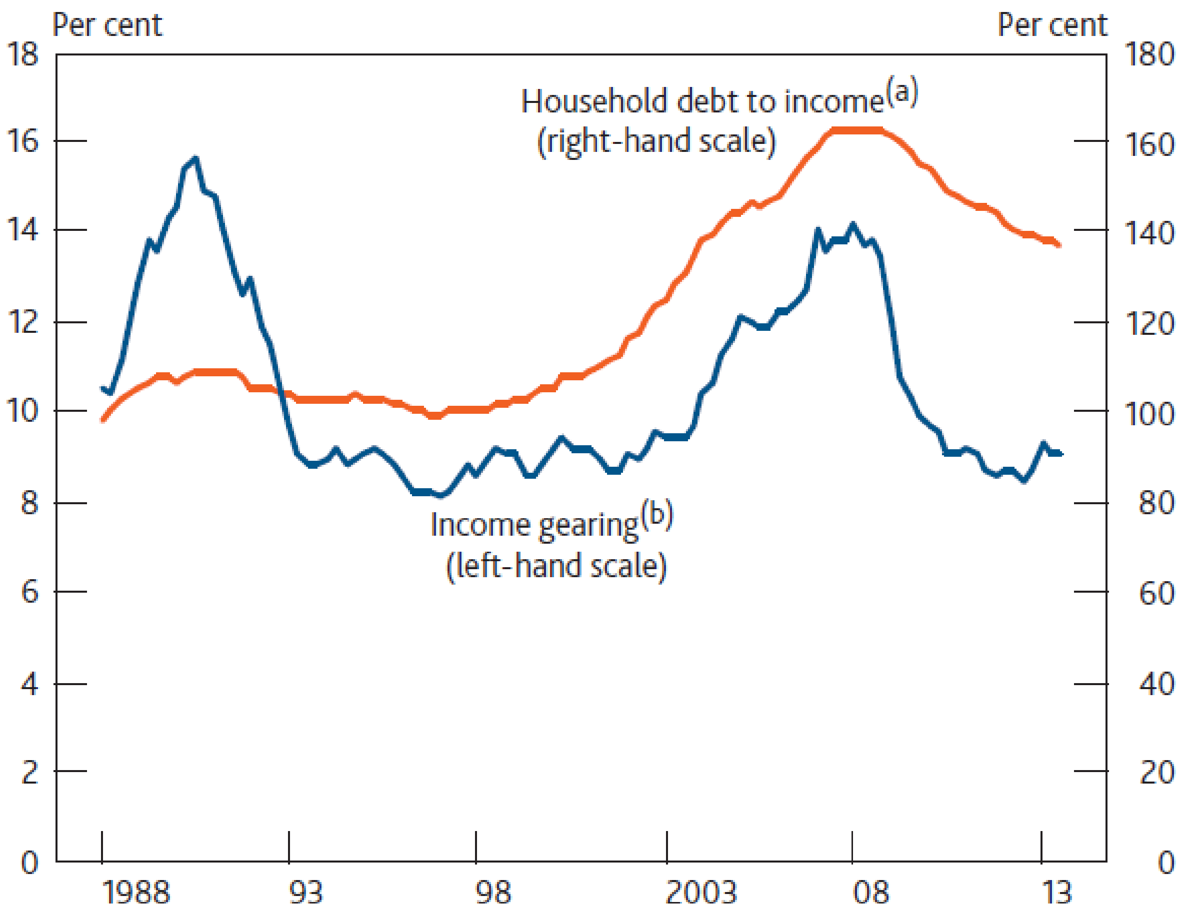
Contributions of household income and saving to real quarterly consumption growth

Percentage points	Quarterly averages				
	1998–2007	2008–09	2010	2011–2012 Q3	2012 Q4–2013 Q3
Total income	0.8	0.1	0.1	0.2	0.0
of which, pre-tax labour income	*0.7*	*-0.4*	*-0.5*	*-0.1*	*0.0*
of which, household taxes and net transfers[b]	*-0.2*	*0.6*	*0.1*	*0.2*	*0.0*
of which, other income[c]	*0.2*	*0.0*	*0.5*	*0.1*	*0.1*
Saving (inverted)[d]	0.1	-0.8	0.2	-0.2	0.6
Consumption (per cent)	0.9	-0.7	0.3	0.1	0.7

Contributions to four-quarter domestic household spending growth



Household debt to income and income gearing ratios



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Source: Research carried out by GfK NOP on behalf of the European Commission.

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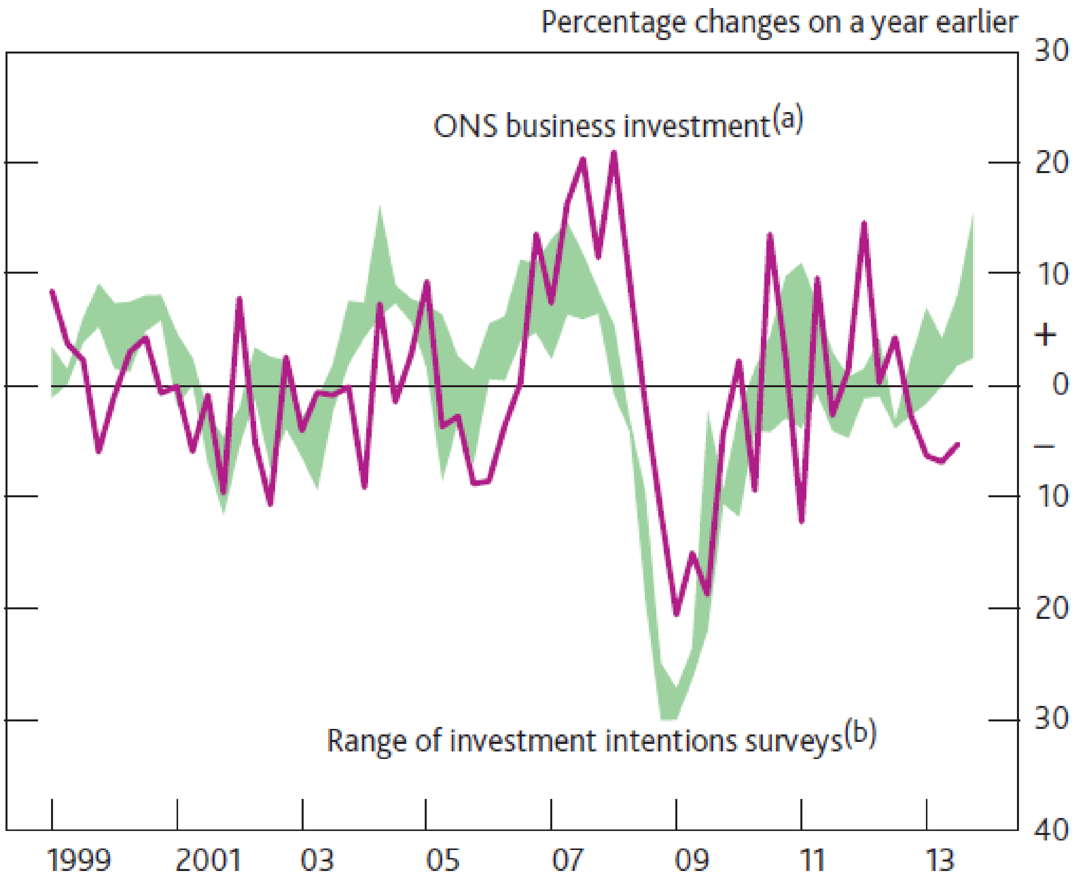
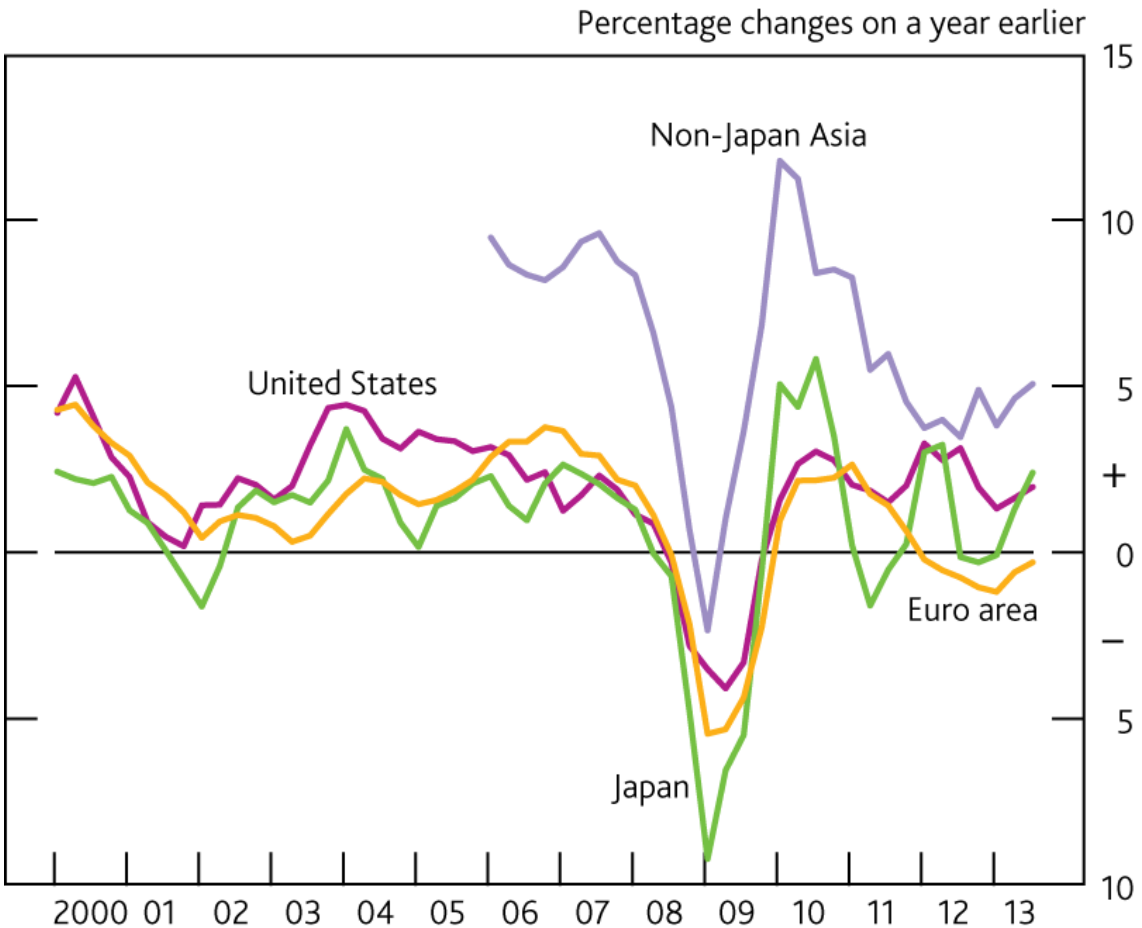
Business investment and surveys of investment intentions

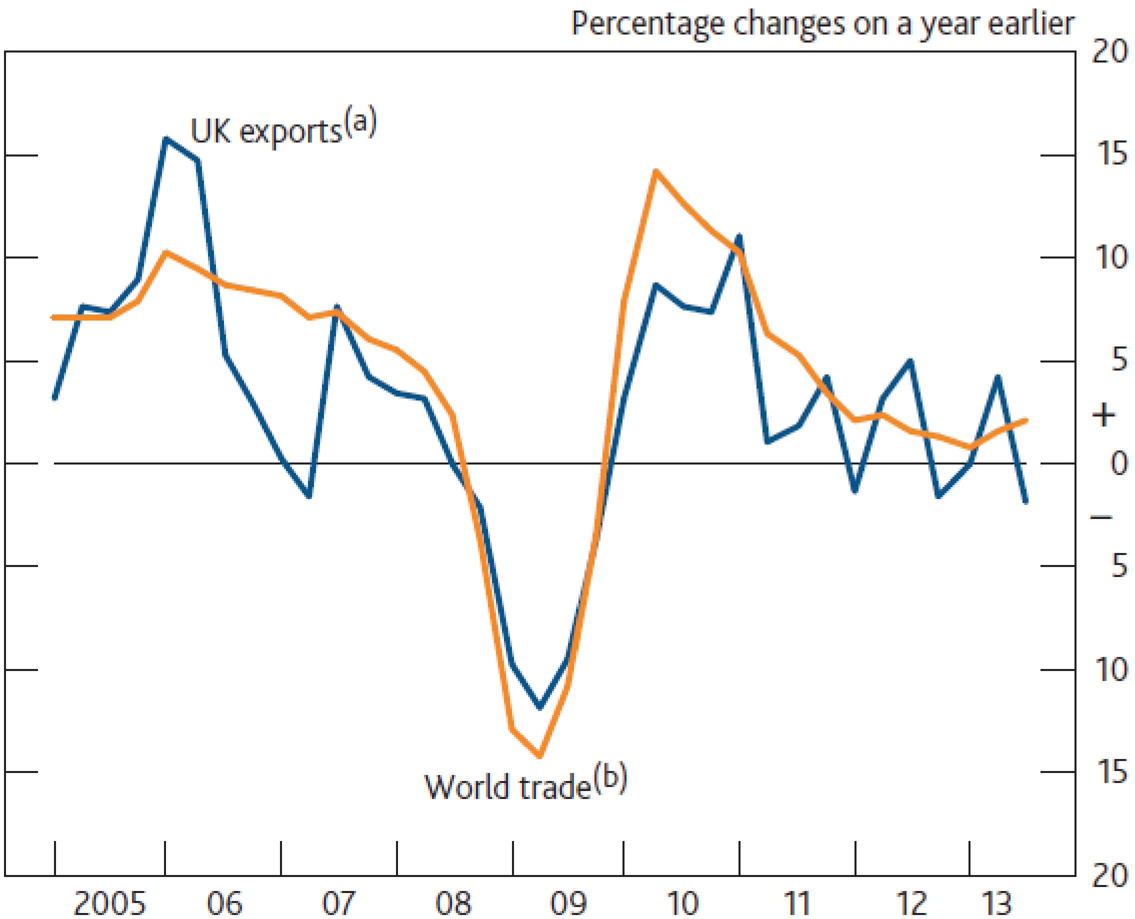


Sources: Bank of England, BCC, CBI, CBI/PwC, ONS and Bank calculations.

International GDP growth

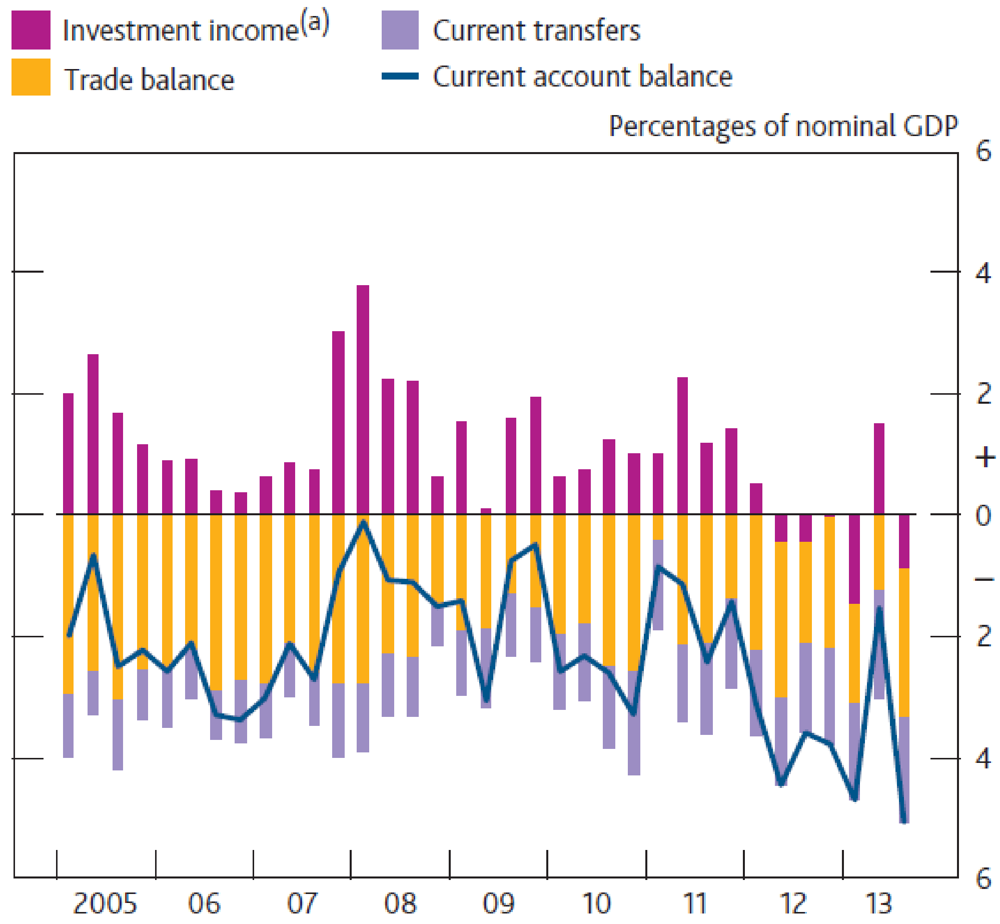


UK-weighted world trade and UK exports



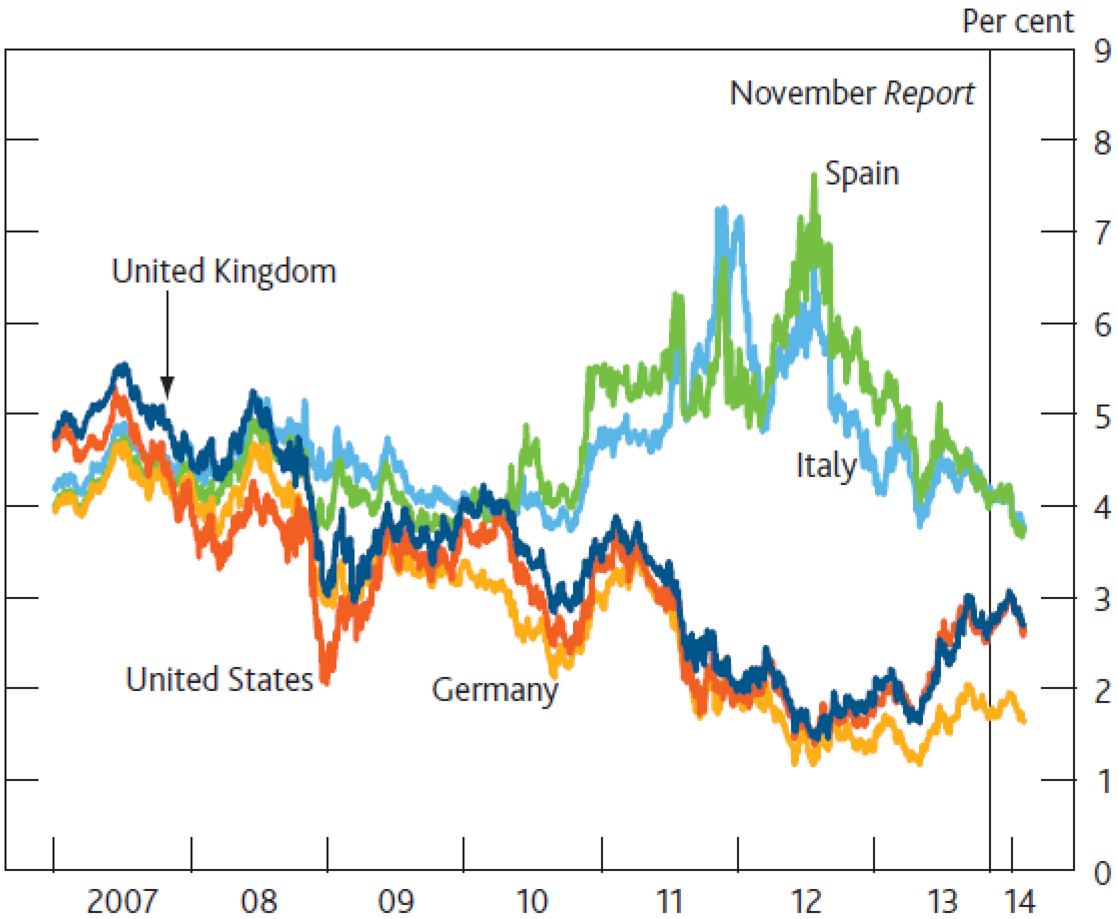
Sources: IMF *WEO* October 2013, OECD, ONS, Thomson Reuters Datastream and Bank calculations.

UK current account



Sterling ERI

Selected ten-year government bond yields



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Source: Bloomberg.

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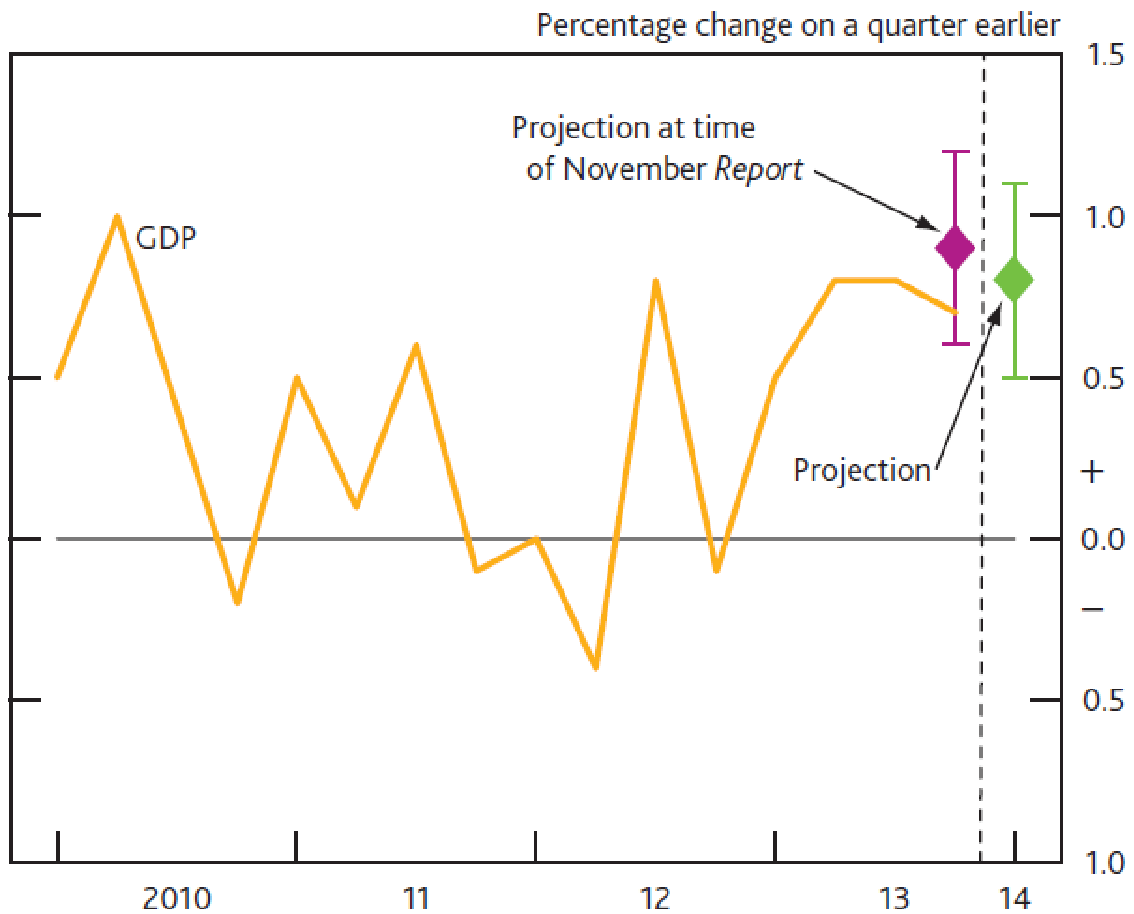
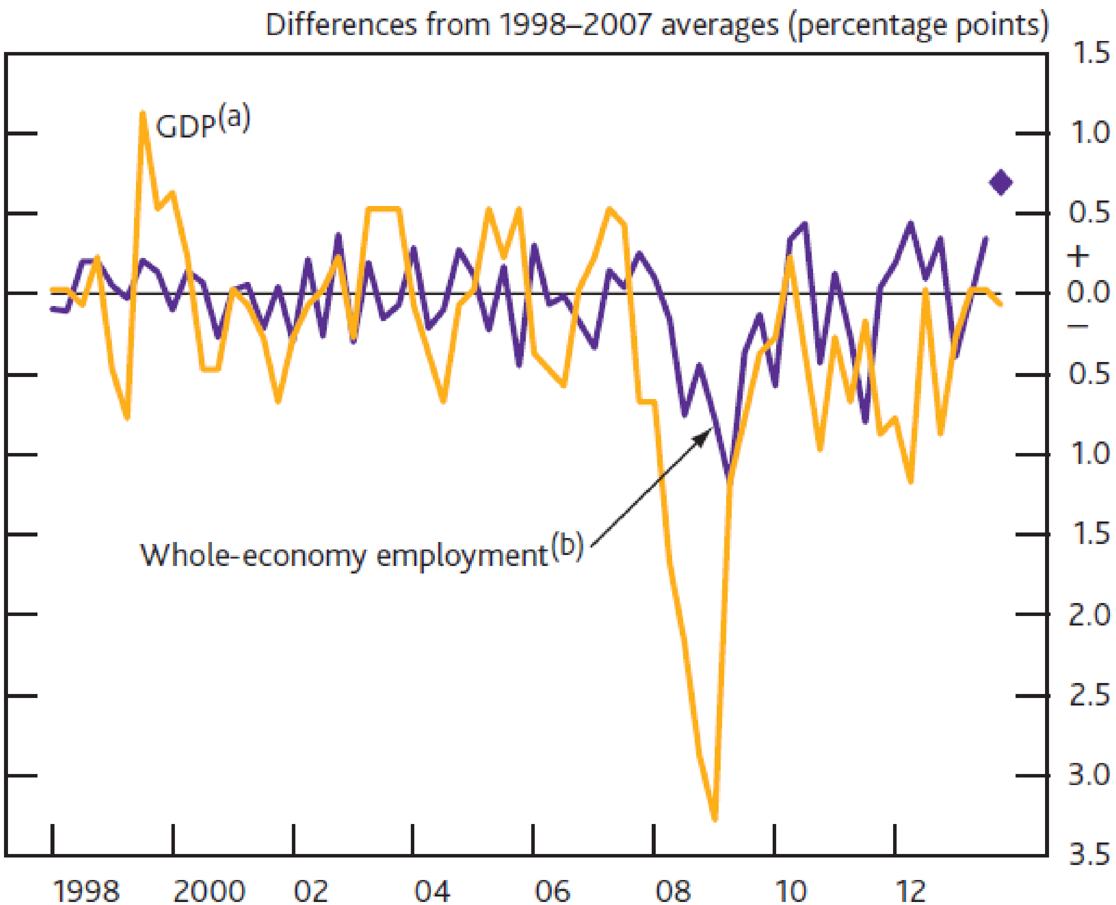
OUTPUT AND EMPLOYMENT

Bank staff projection for near-term output

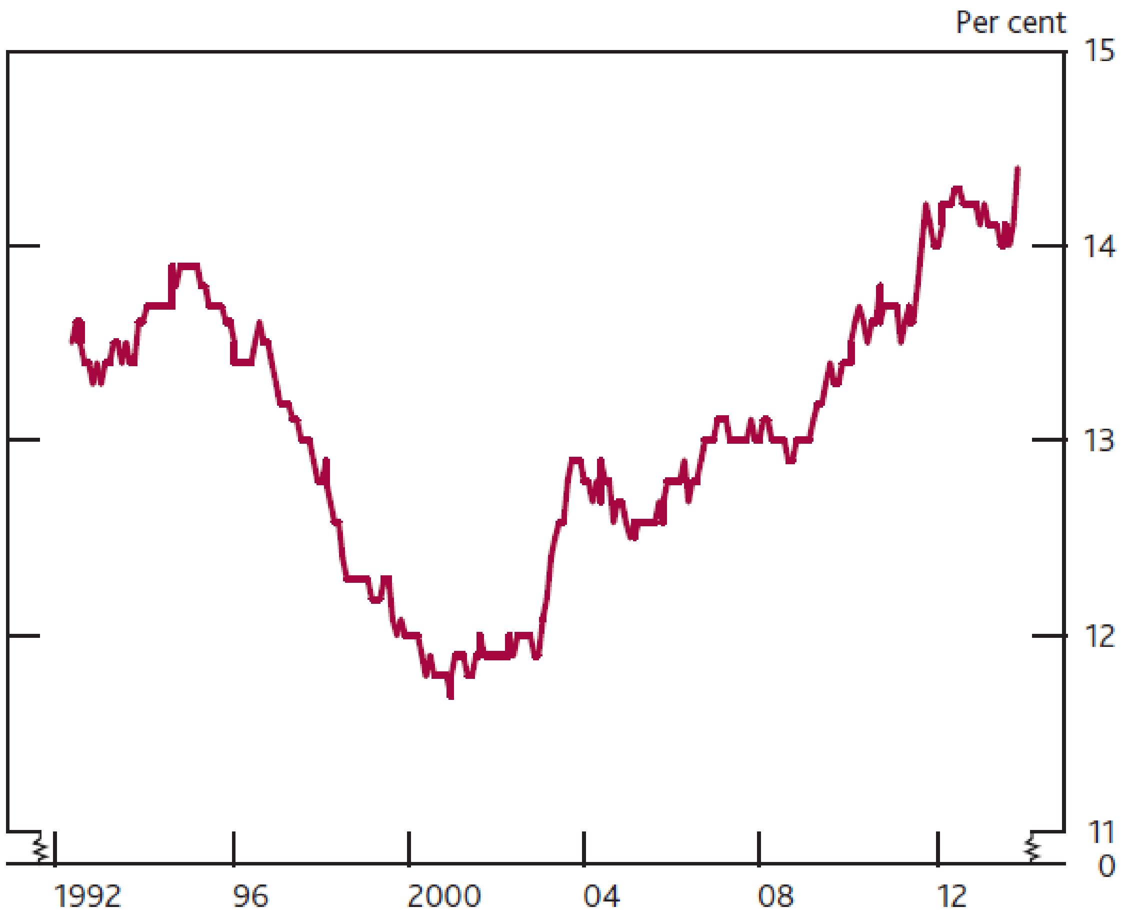


Quarterly growth in whole-economy output and employment

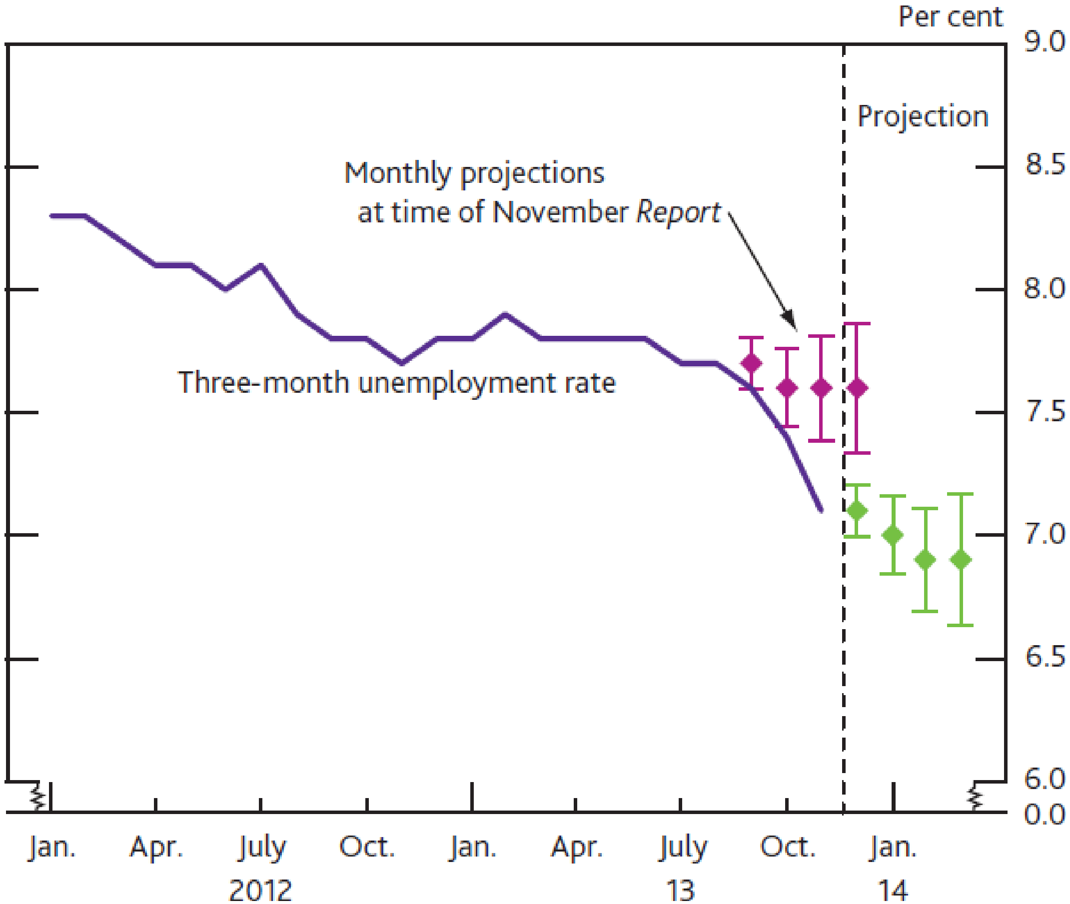


Source: ONS (including the Labour Force Survey).

Self-employment share

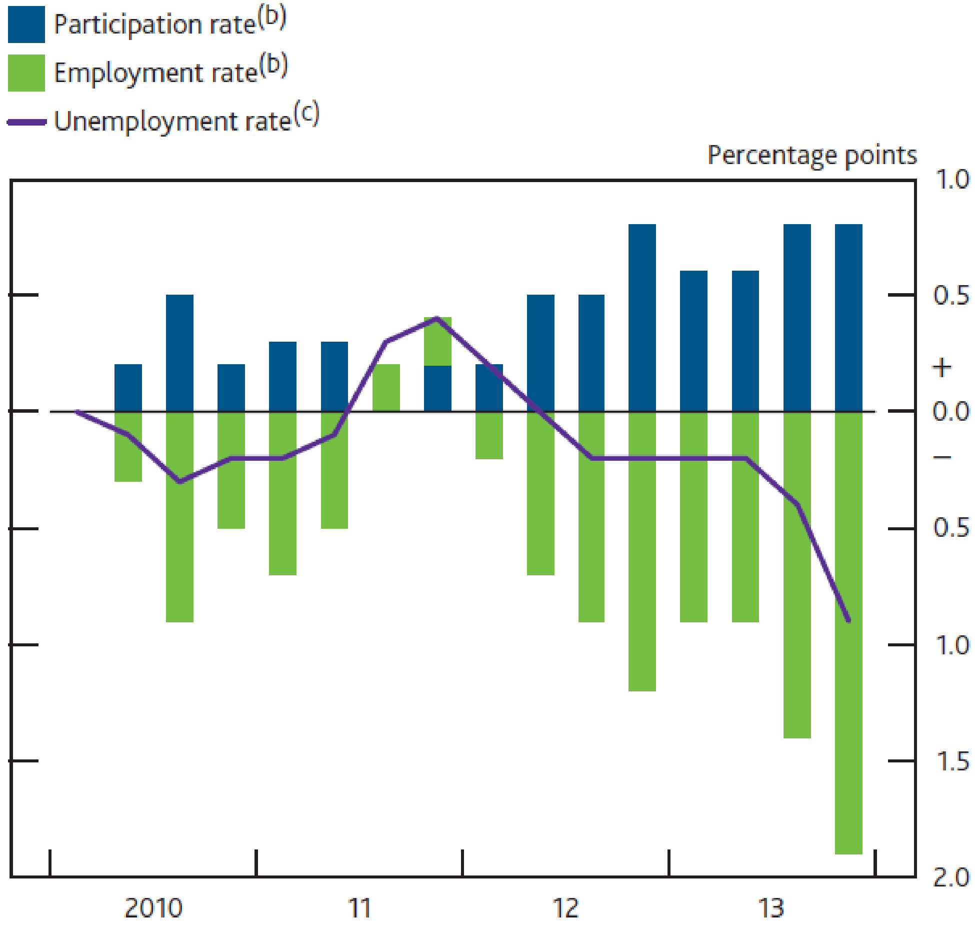


Bank staff projection for the near-term headline LFS unemployment rate



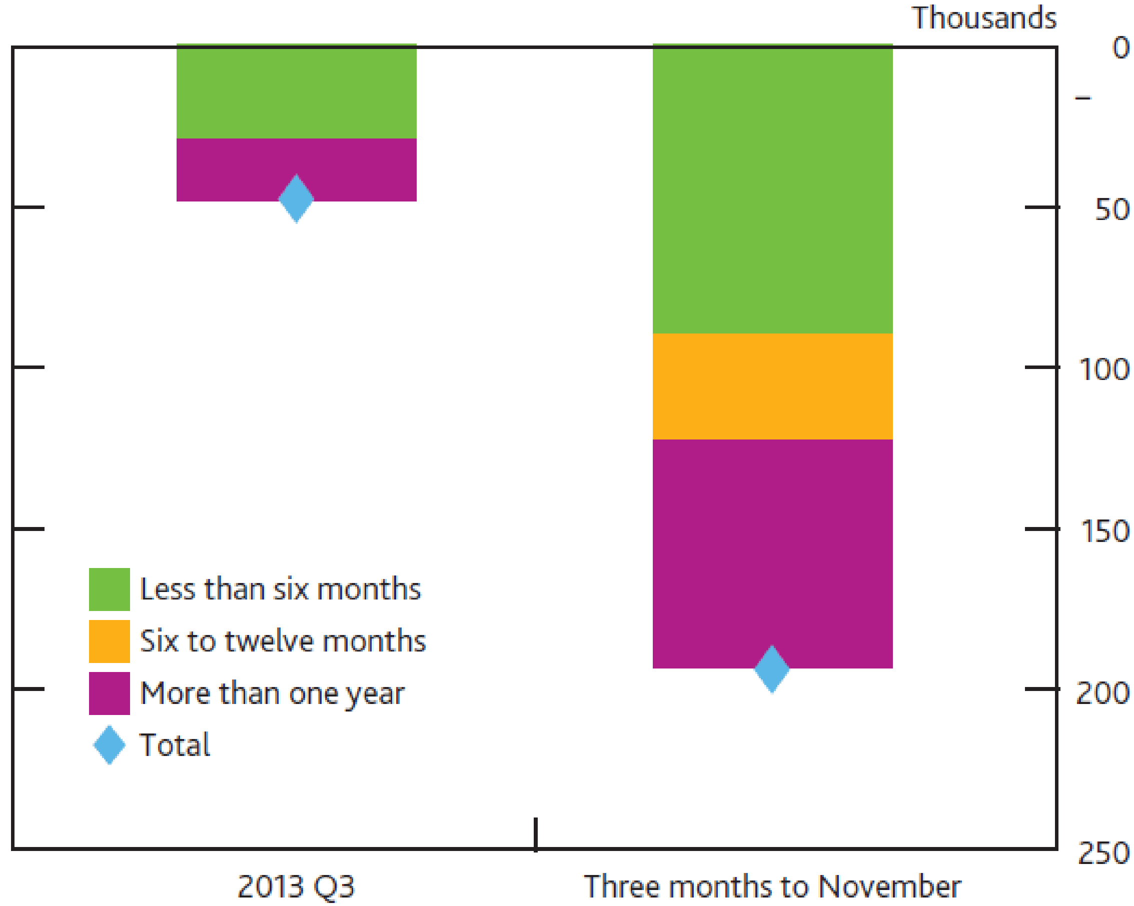
Sources: Labour Force Survey and Bank calculations.

Contributions to the change in the unemployment rate since 2010 Q1



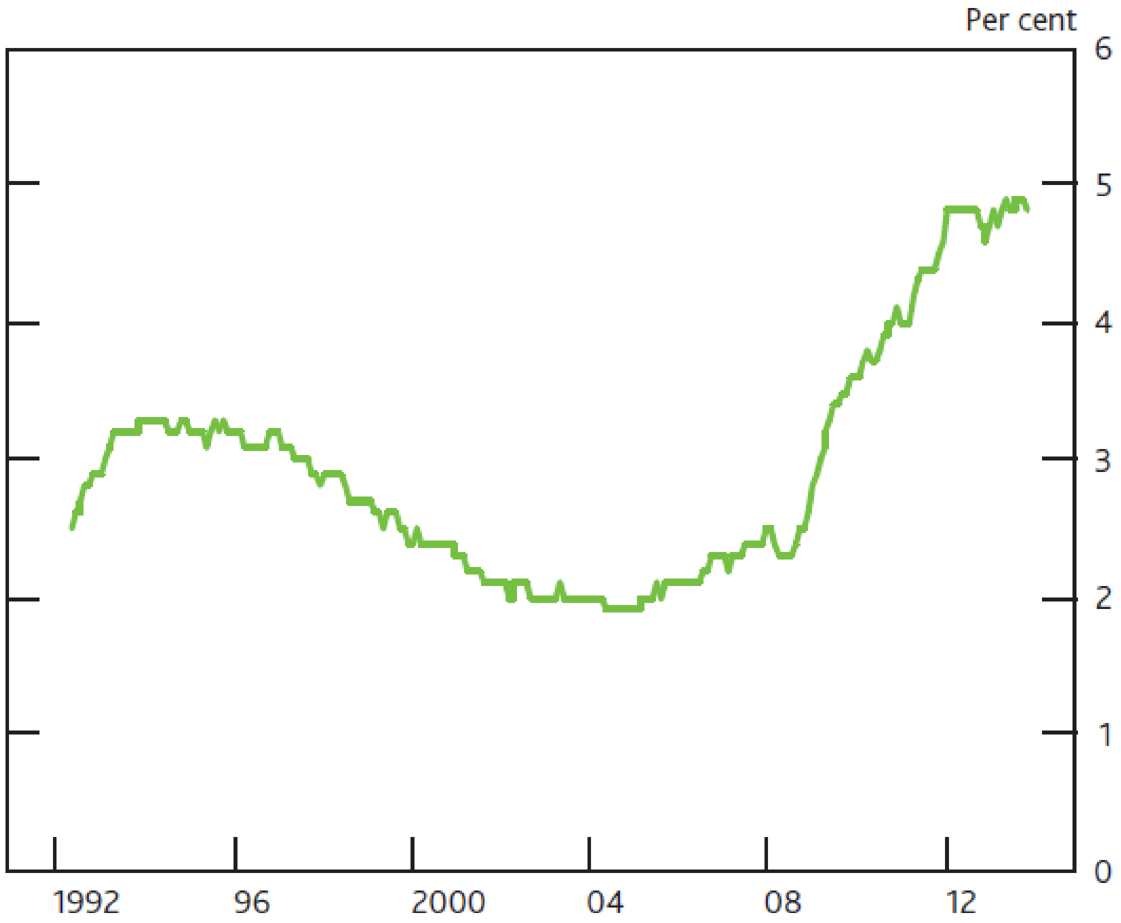
Sources: Labour Force Survey and Bank calculations.

Contributions to the fall in unemployment since 2013 Q2 by duration



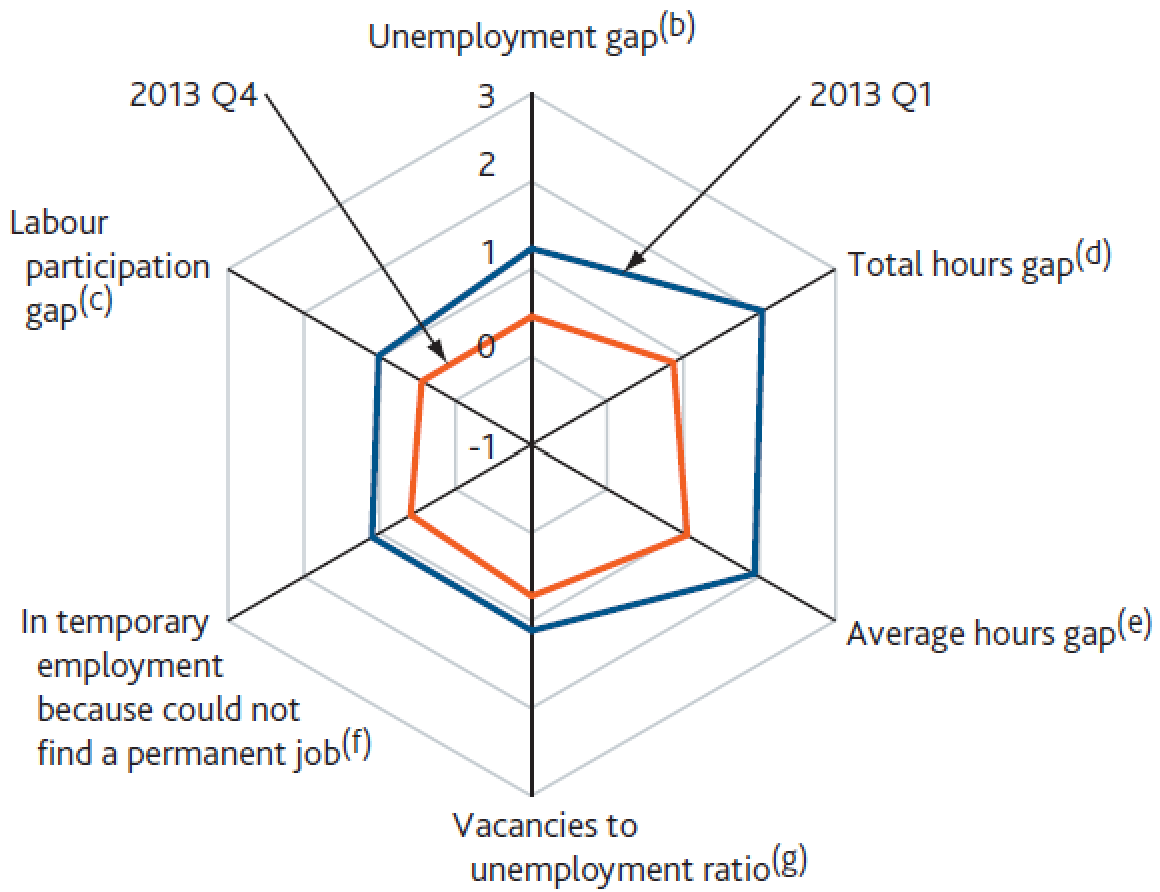
Source: Labour Force Survey

Part-time employees who could not find full-time work



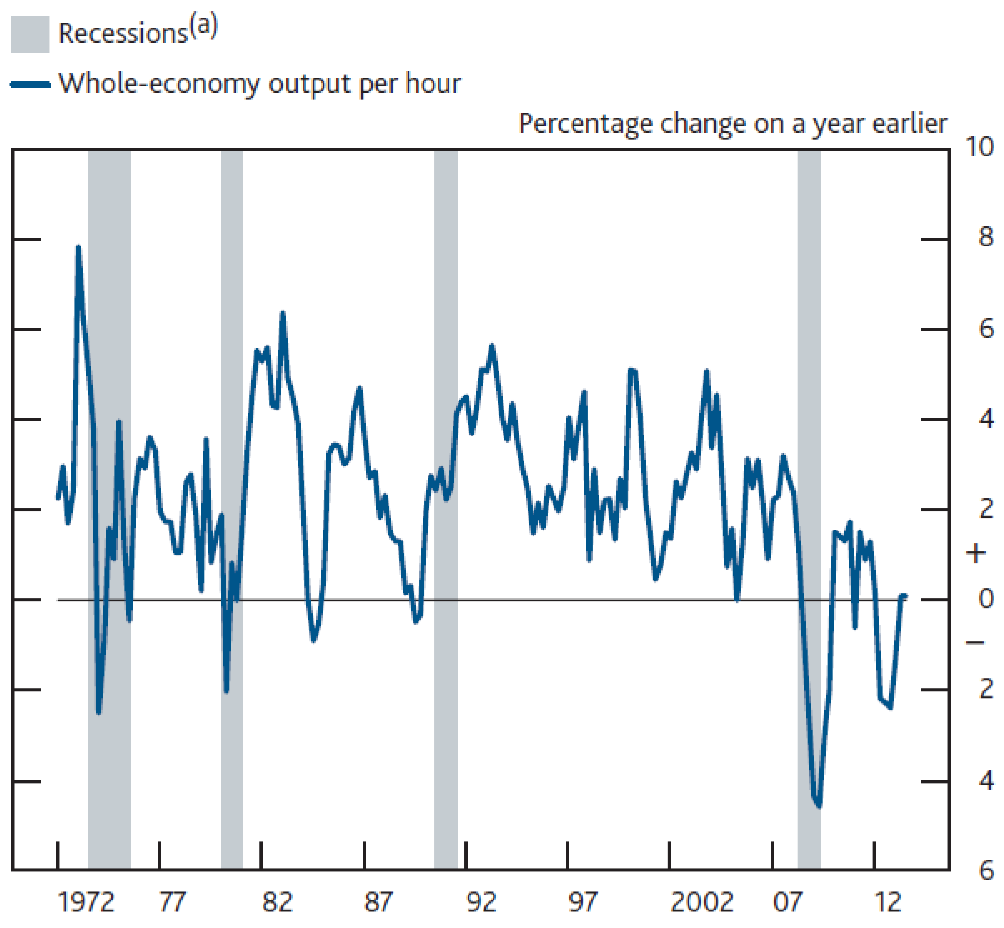
Source: Labour Force Survey.

Selected indicators of labour market slack



Sources: ONS (including the Labour Force Survey) and Bank calculations.

Labour productivity



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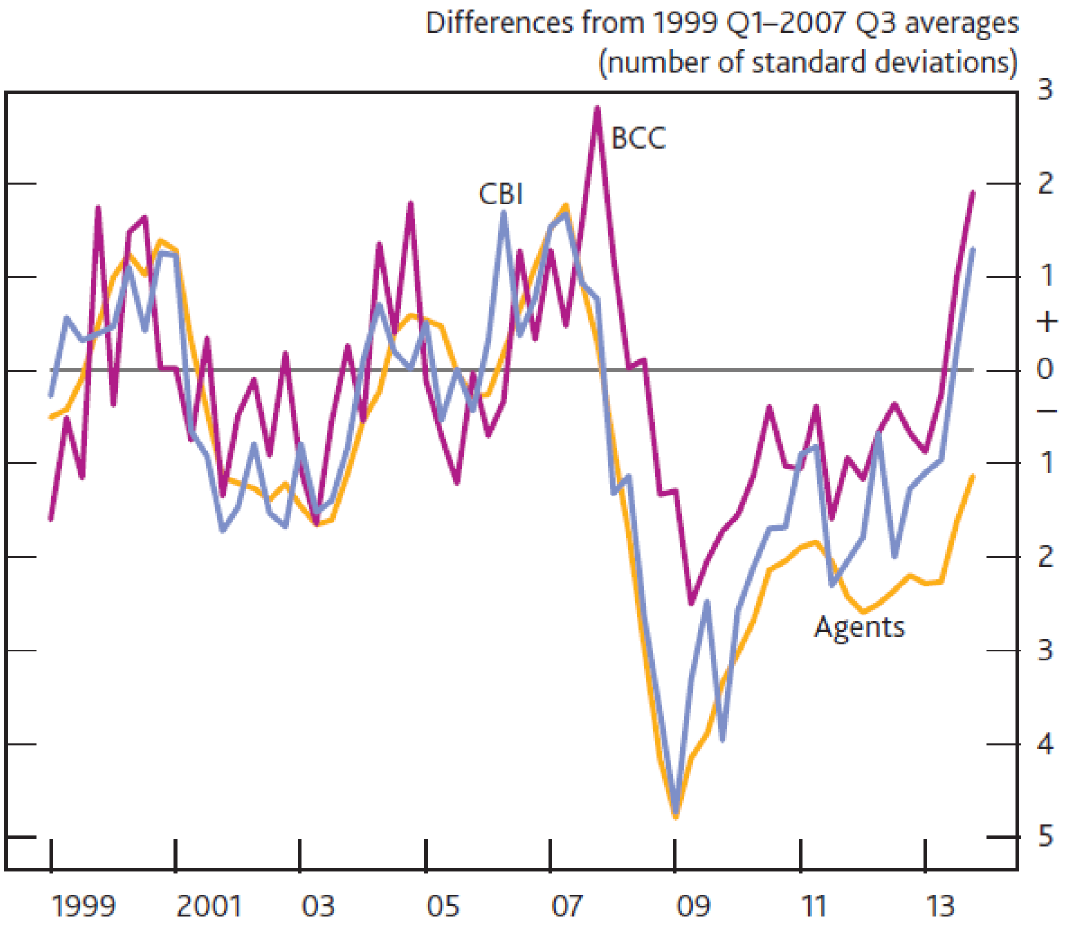
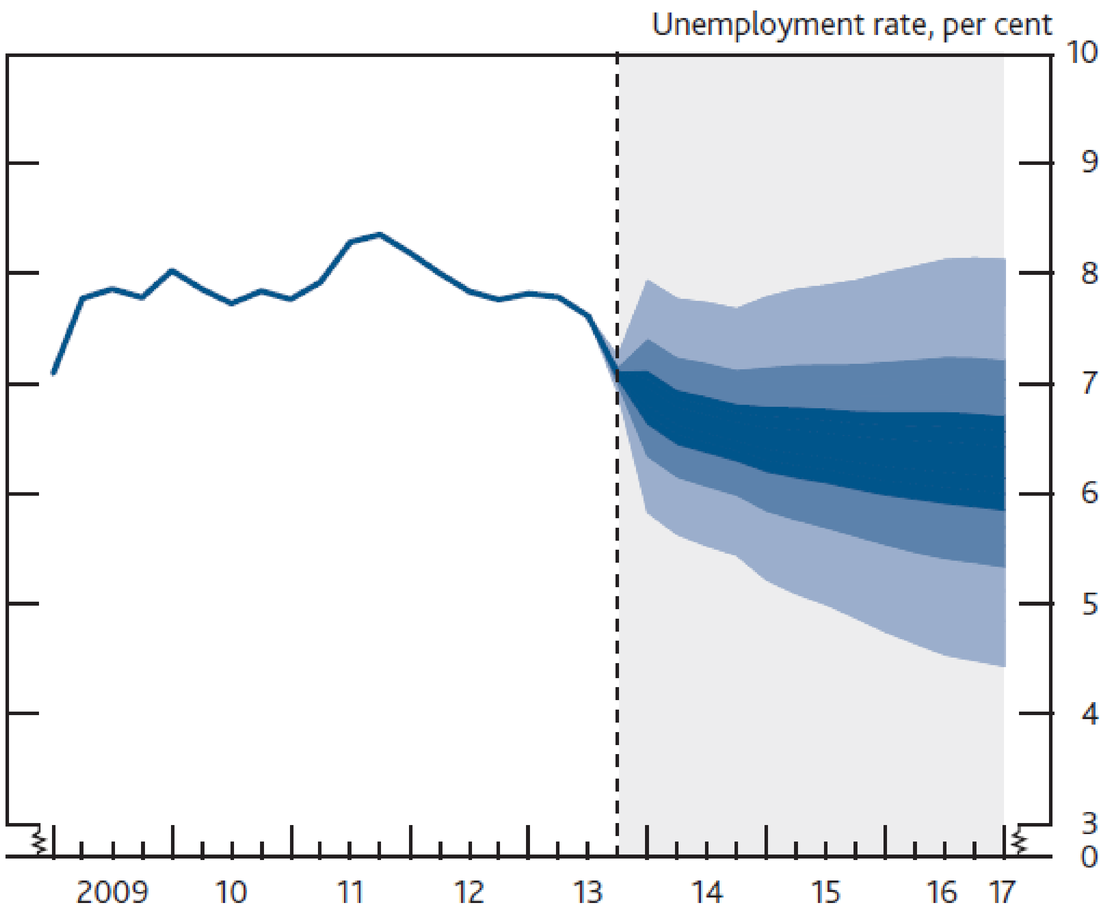
Sources: ONS (including the Labour Force Survey).

Survey indicators of capacity utilisation



Sources: Bank of England, BCC, CBI/PwC, ONS and Bank calculations

Unemployment projection based on market interest rate expectations and £375 billion purchased assets



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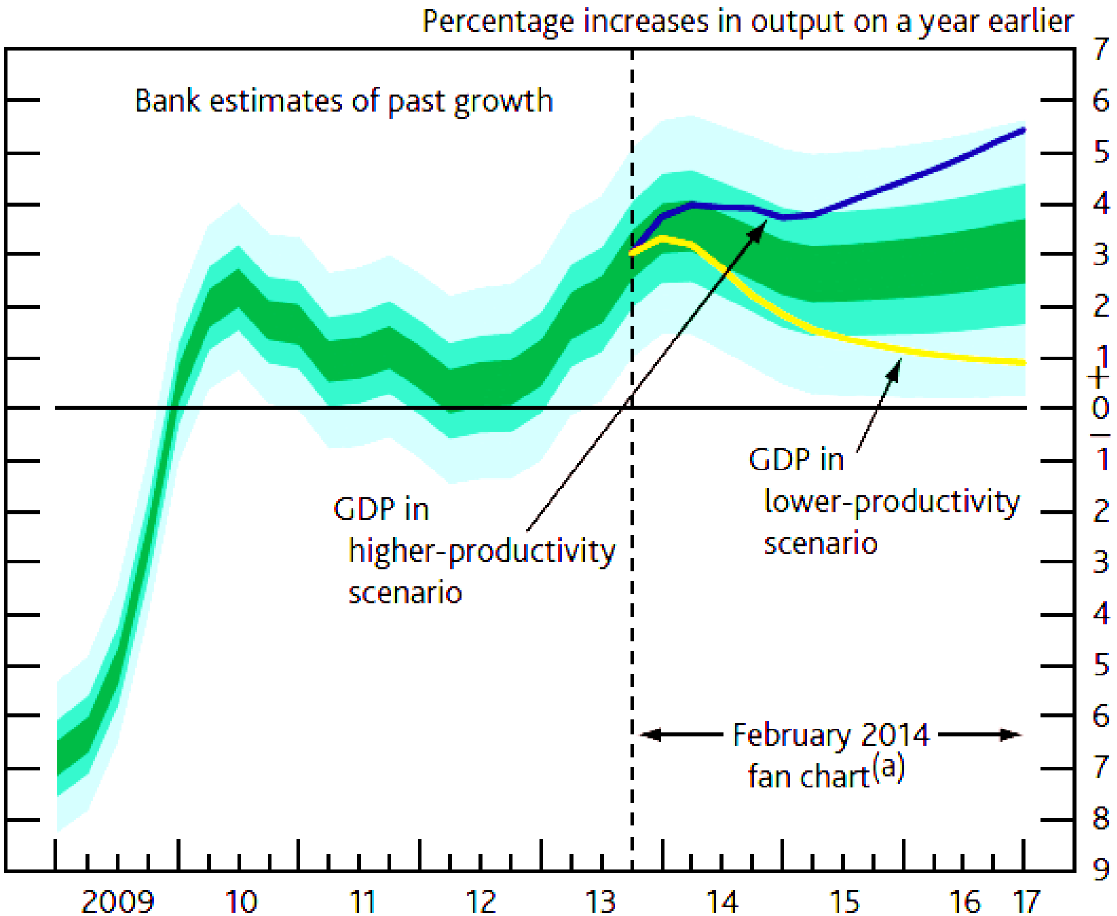
GDP projection and alternative scenarios



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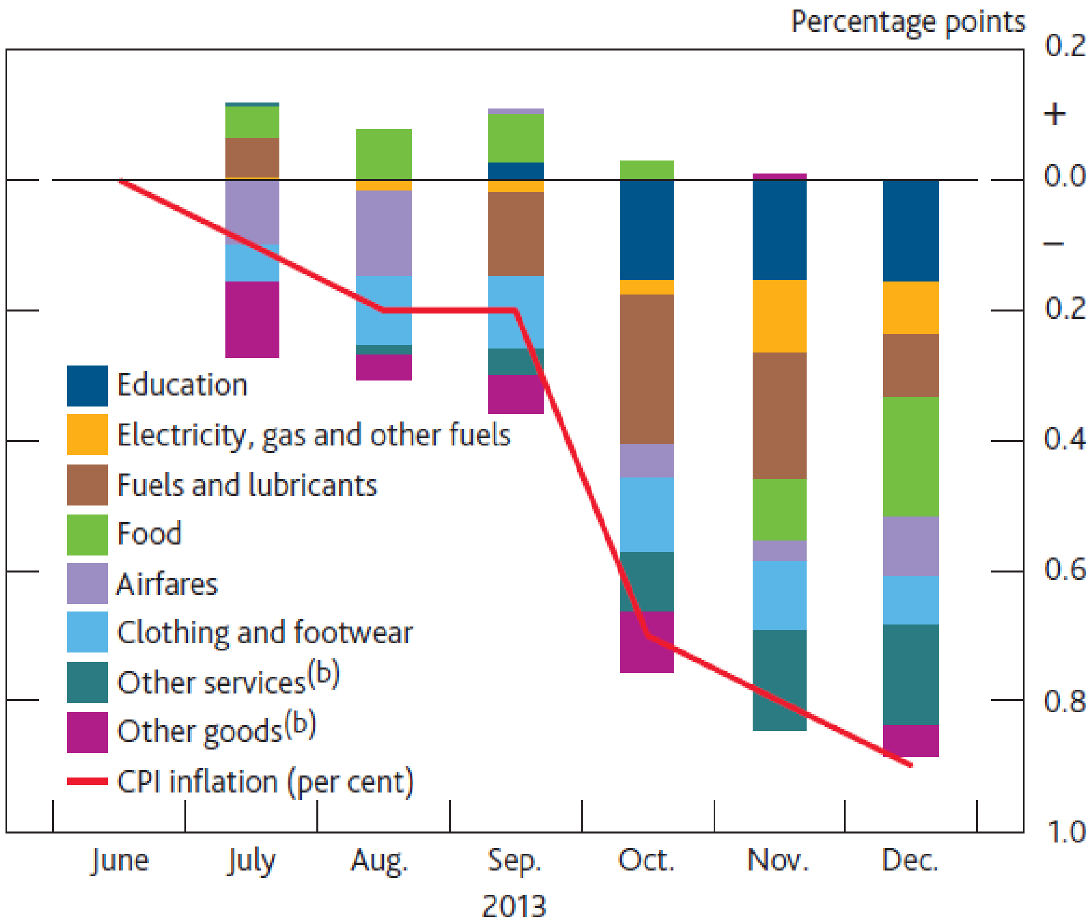
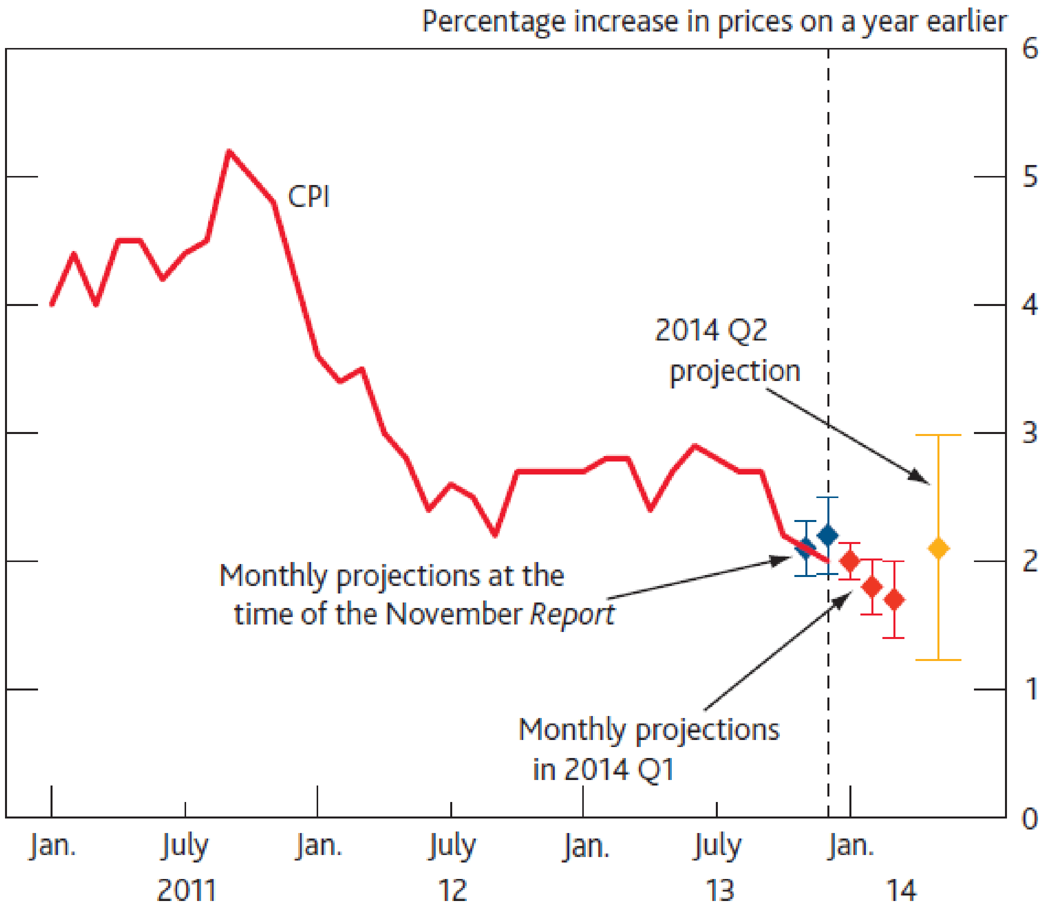
INFLATION

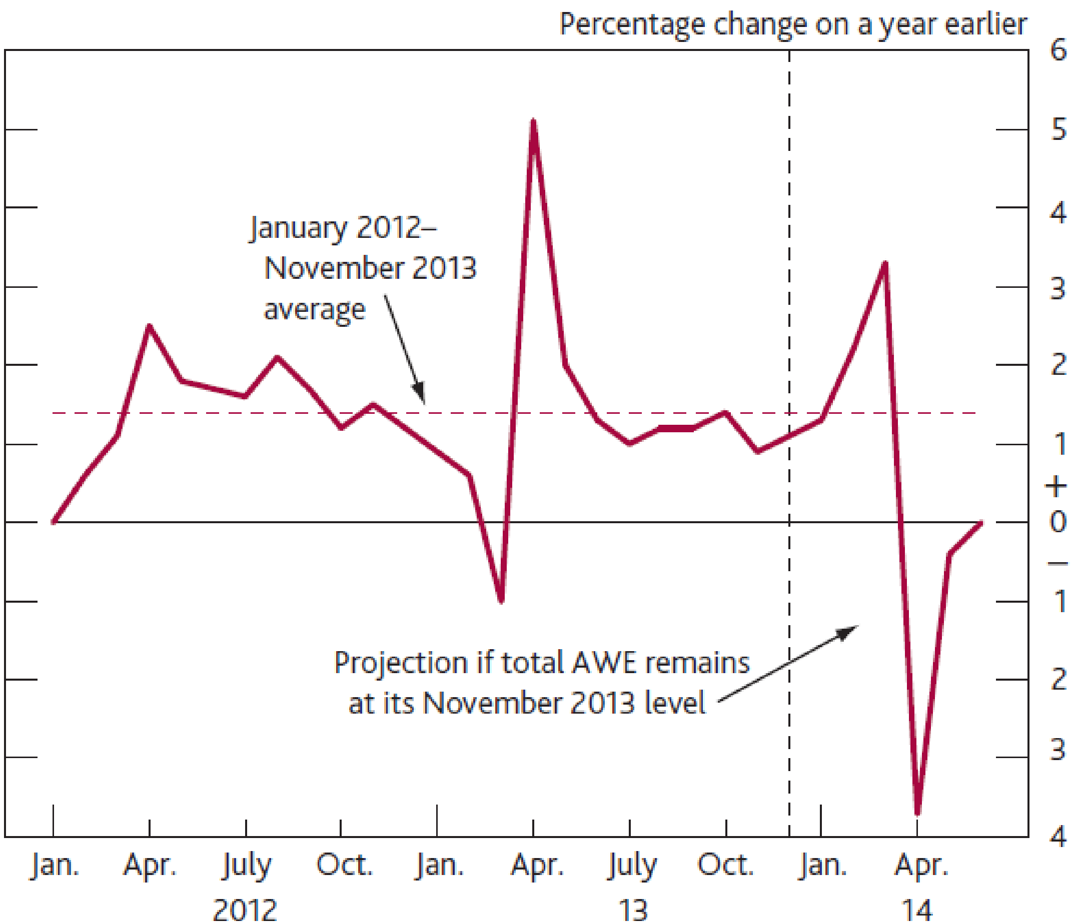
Contributions to the change in annual CPI inflation since June 2013



Bank staff projection for near-term CPI inflation

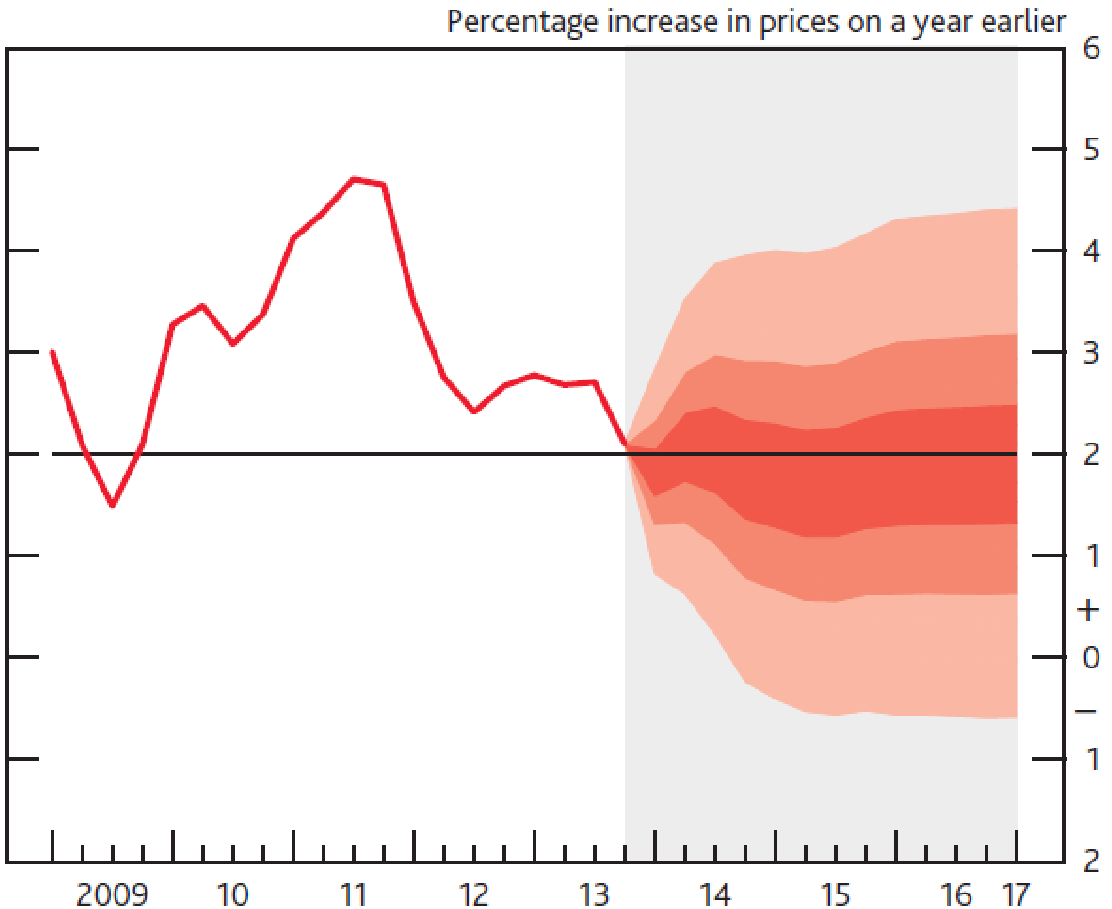


Single-month measure of private sector total earnings and illustration of base effects



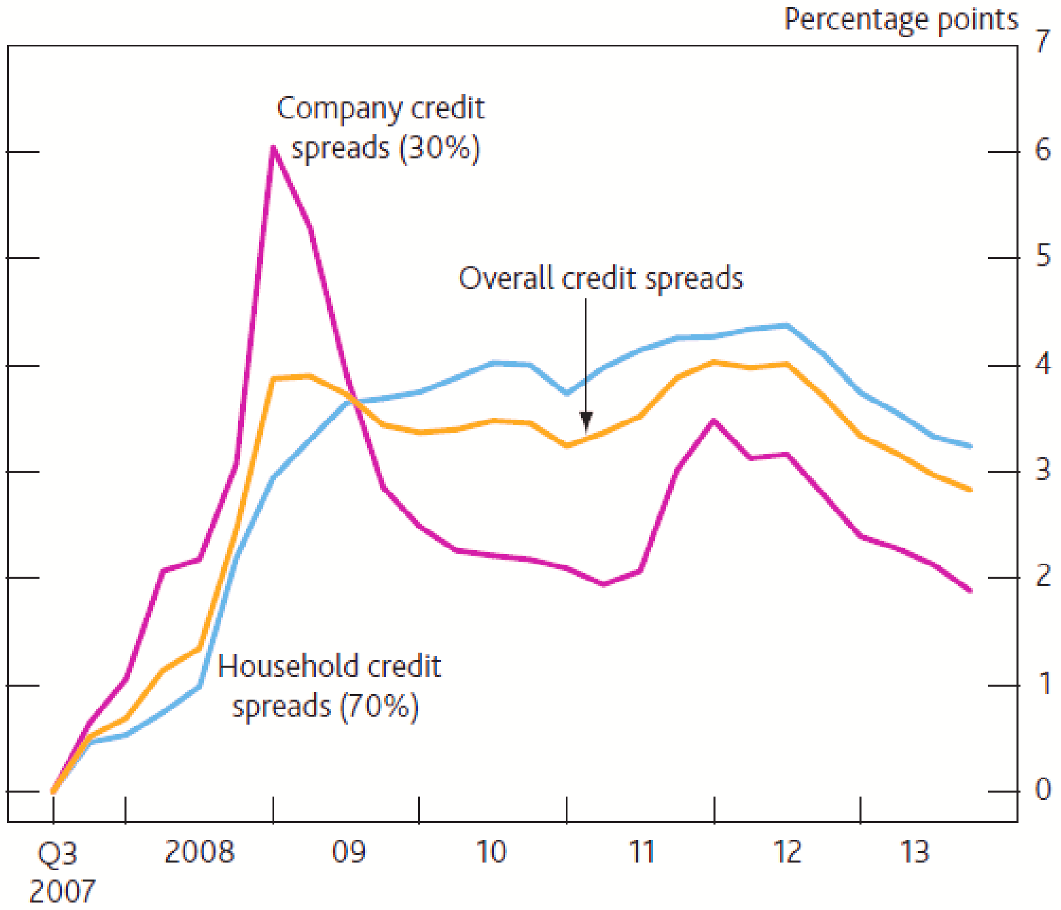
Sources: ONS and Bank calculations.

CPI inflation projection based on market interest rate expectations and £375 billion purchased assets



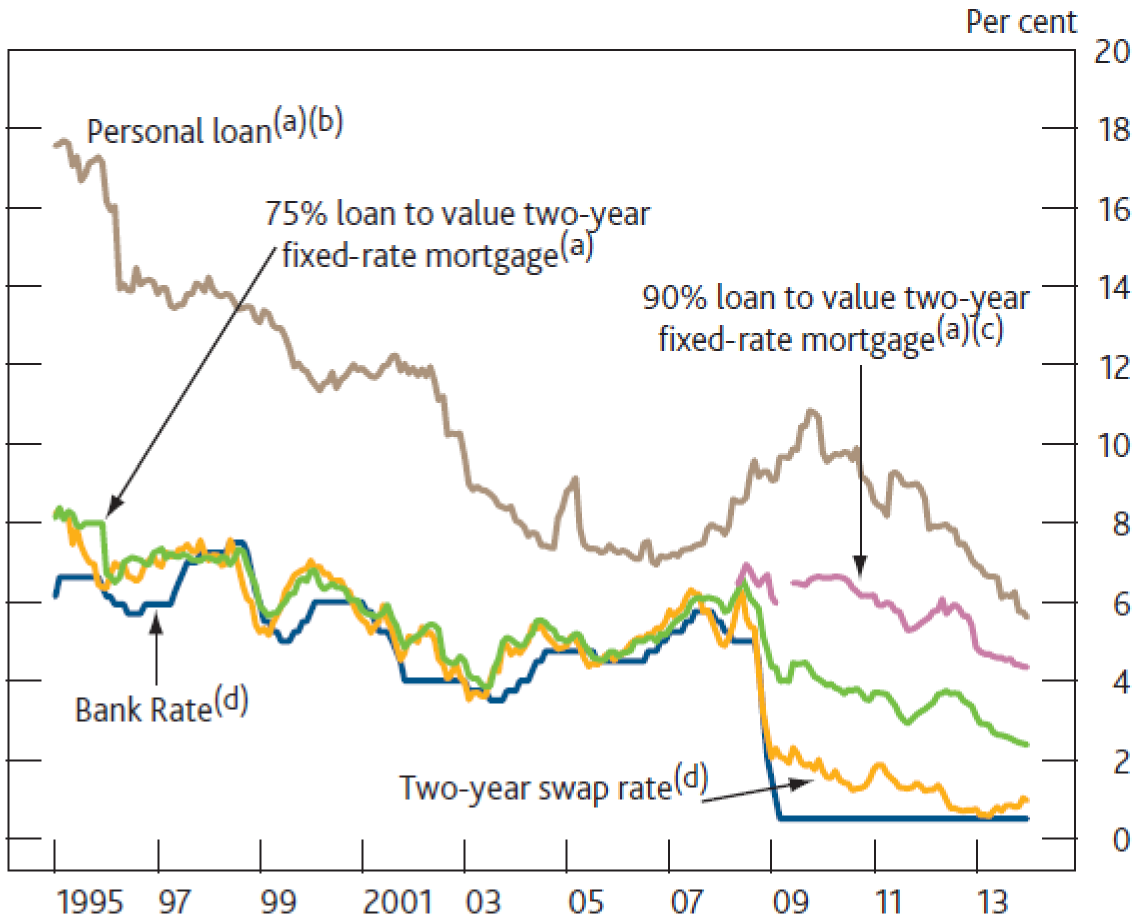
CREDIT CONDITIONS

Changes since 2007 Q3 in indicators of household and company credit spreads

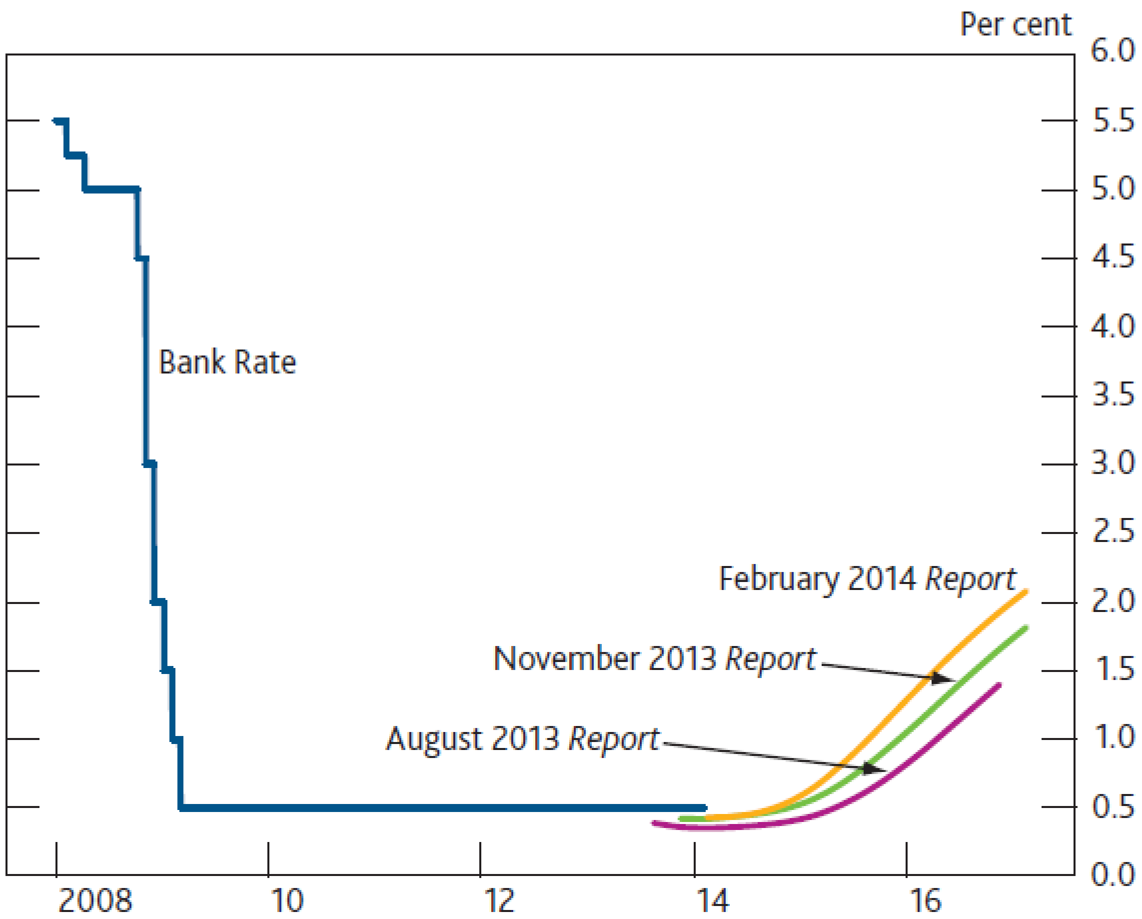


Sources: Bank of England, BDRC Continental *SME Finance Monitor*, Bloomberg, BofA Merrill Lynch Global Research, used with permission, British Household Panel Survey, Department for Business, Innovation and Skills and Bank calculations.

Bank Rate and quoted rates on household borrowing



Bank Rate and forward market interest rates



Sources: Bank of England and Bloomberg.

POLICY

Guidance: Phase 1

- Policy is aimed at achieving the inflation target while sustaining the recovery
  - Last August:
    - Slack plentiful, though scope for productivity to recover uncertain
    - Concern that resumption of growth could prompt expectations of higher Bank Rate even though considerable slack remained
    - OK to pick small set of indicators as <u>necessary</u> condition for tightening policy
    - Unemployment a key component of slack (<u>not</u> a comprehensive indicator); scope to fall (to 7%) before even thinking about tightening policy
    - Purpose was to give more information about policy as economy recovered

Guidance: Beyond Phase 1

- Phase 2 (after 7% threshold reached)

“*Despite the sharp fall in unemployment, there remains scope to absorb spare capacity further before raising Bank Rate*”.

Guidance: Beyond Phase 1 (continued)

- Phase 3 (after Bank Rate lift-off)

"When Bank Rate does begin to rise, the appropriate path so as to eliminate slack over the next two to three years and keep inflation close to the target is expected to be gradual".

"The actual path of Bank Rate over the next few years will, however, depend on economic developments."

"Even when the economy has returned to normal levels of capacity and inflation is close to the target, the appropriate level of Bank Rate is likely to be materially below the 5% level set on average by the Committee prior to the financial crisis."

Guidance: Beyond Phase 1 (continued)

- Aim to provide some idea of likely trajectory for Bank Rate
- Equilibrium real interest rate turned negative during the Great Recession
- Has subsequently risen, but headwinds from financial crisis and weak euro-area recovery plus high global savings mean it is likely to remain low
- So even when slack eliminated and inflation at target, appropriate level of Bank Rate likely to be materially below the 5% average prior to the crisis
- In addition, appropriate path to eliminate slack and keep inflation near target is expected to rise gradually (<u>actual</u> path will depend on economic developments)

Guidance: Beyond Phase 1 (continued)

- *"The MPC intends to maintain the stock of purchased assets [ie, Quantitative Easing] at least until the first rise in Bank Rate."*

- *"Monetary policy may have a role to play in mitigating risks to financial stability, but only as a last line of defence if those risks cannot be contained by the substantial range of policy actions available to the Financial Policy Committee and other regulatory authorities."*