BANK OF ENGLAND

Inflation Report presentation

September 2013

Stephen Collins & Geoff Harding

Agency for South West England

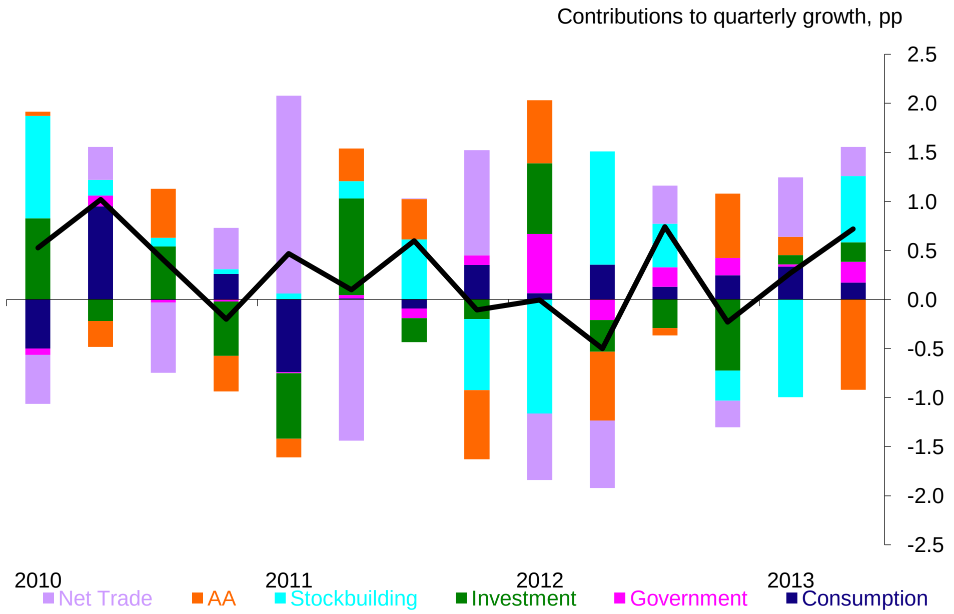
Headlines

- New term, new Governor
- Growth projection revised up, but the outlook is “solid, not stellar”
- Not much change to the inflation outlook
- Credit conditions have continued to ease, broadly in line with the MPC’s expectations
- All the major central banks are dampening down bank rate expectations
- Explicit forward guidance on UK monetary policy for the first time

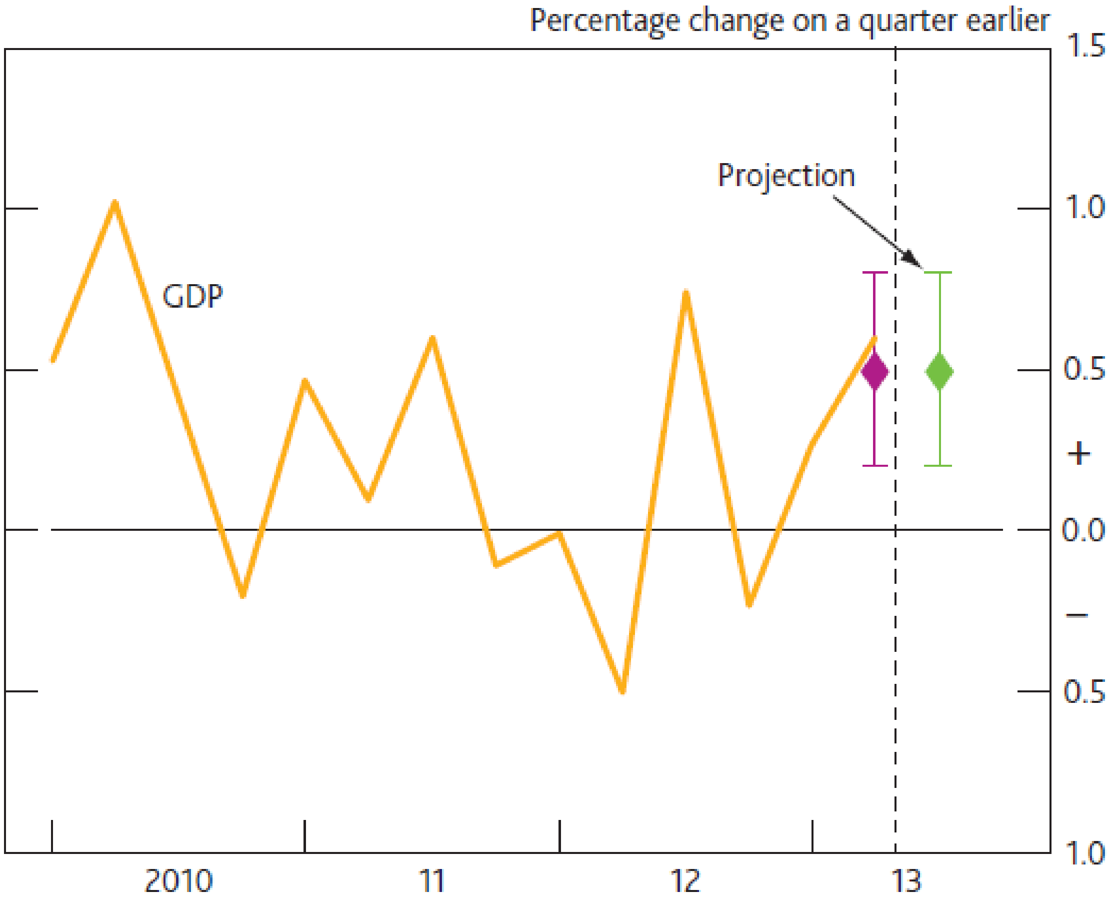
- Growth projection
- Inflation projection
- Credit conditions
- MPC's key assumptions
- Forward guidance on Bank Rate

23rd August's revised quarterly GDP figures – Demand

	Q1	Q2
	+0.3%	+0.7%
C	+0.5%	+0.3%
I	+0.7%	+1.4%
G	+0.1%	+0.9%
(X-M)	+0.6%	+0.3%
Stock	-1.0%	+0.7%



Bank staff projection for near-term output growth

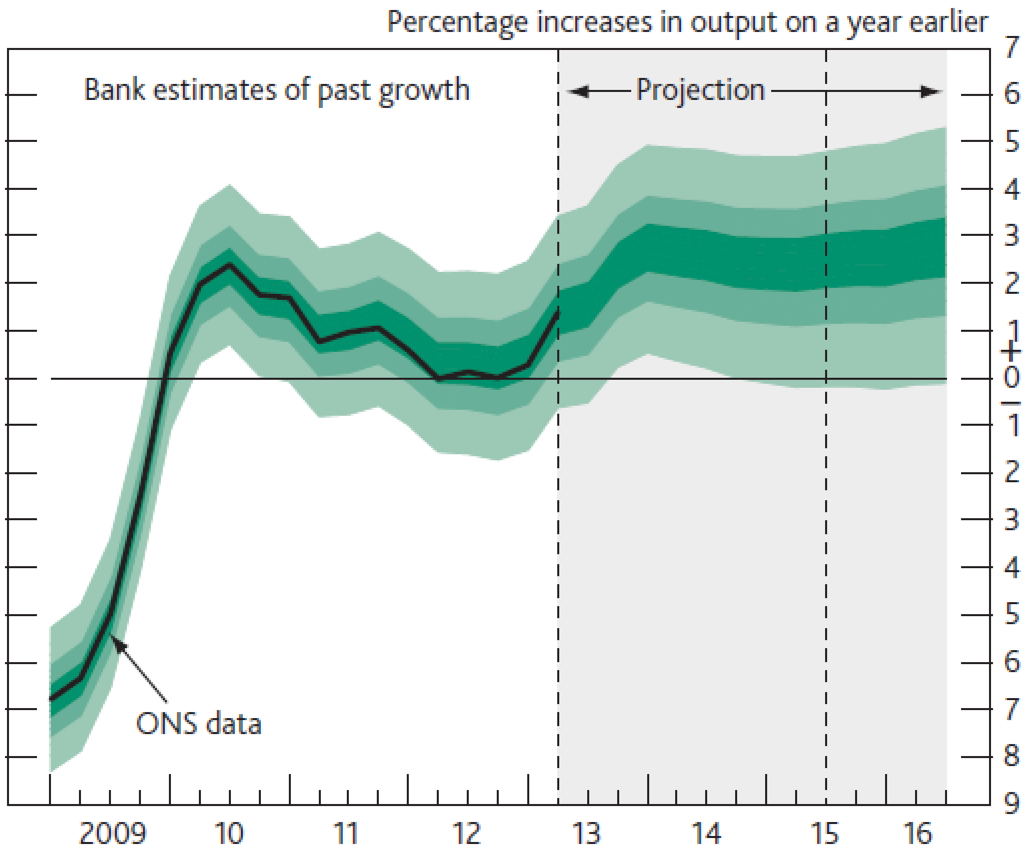


Inflation Report commentary

“A recovery appears to be taking hold. But the legacy of adjustment and repair left by the financial crisis means that the recovery is likely to remain weak by historical standards.

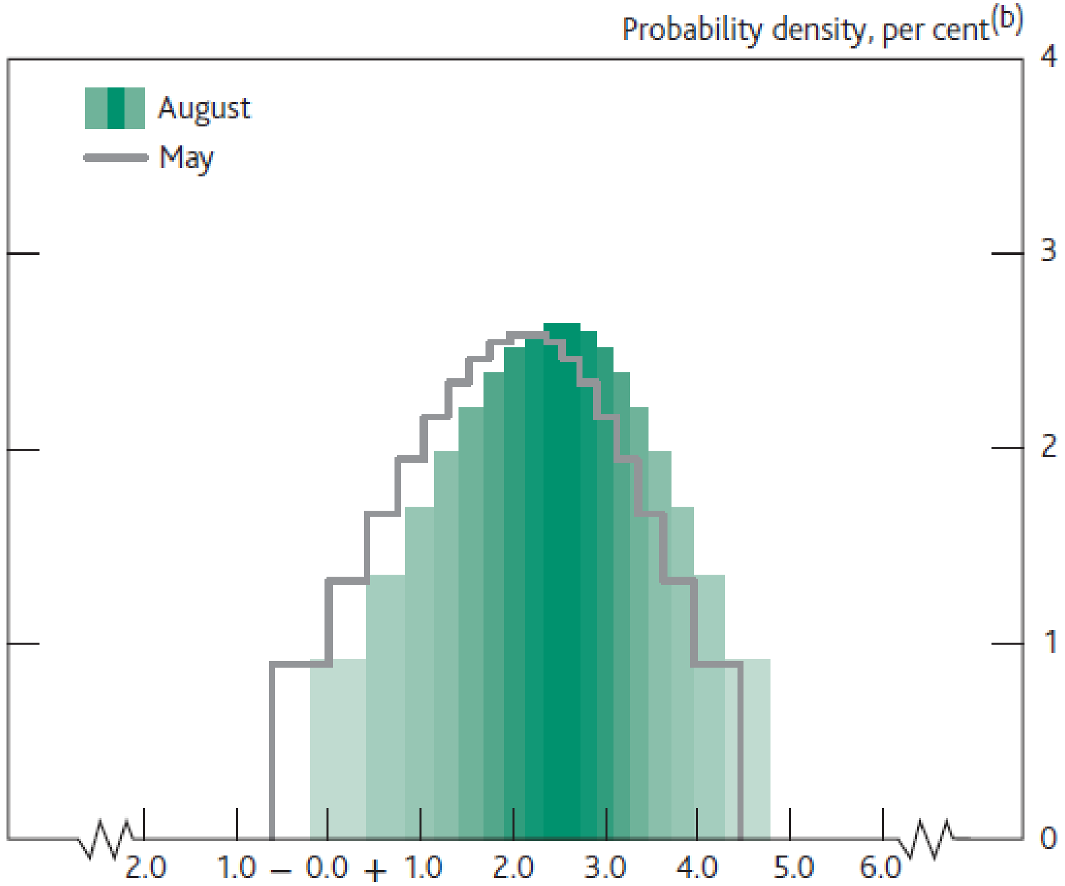
In the Committee’s view a sustained recovery in both demand and supply appears likely. The outlook for growth is stronger than in May, mainly reflecting a marked improvement in business and consumer sentiment.”

GDP growth rate projection based on constant nominal interest rates at 0.5% and £375 billion asset purchases



Projected probabilities of GDP growth in 2015 Q3 (central 90% of the distribution) -

50% chance of output being at or below 2.4% in two years' time

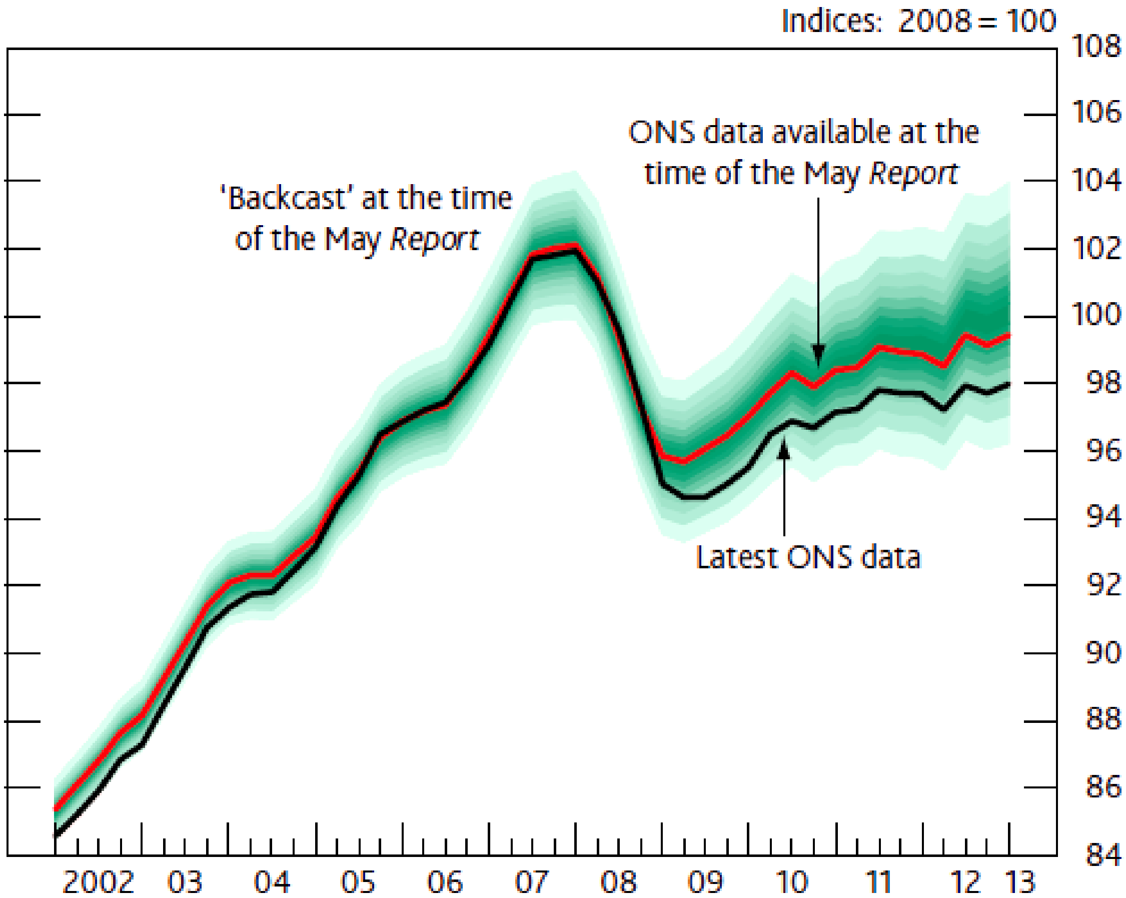


MPC's evaluation of GDP at the time of the May Report, ONS data at that time and latest ONS data

Peak to trough, a 7% fall in output

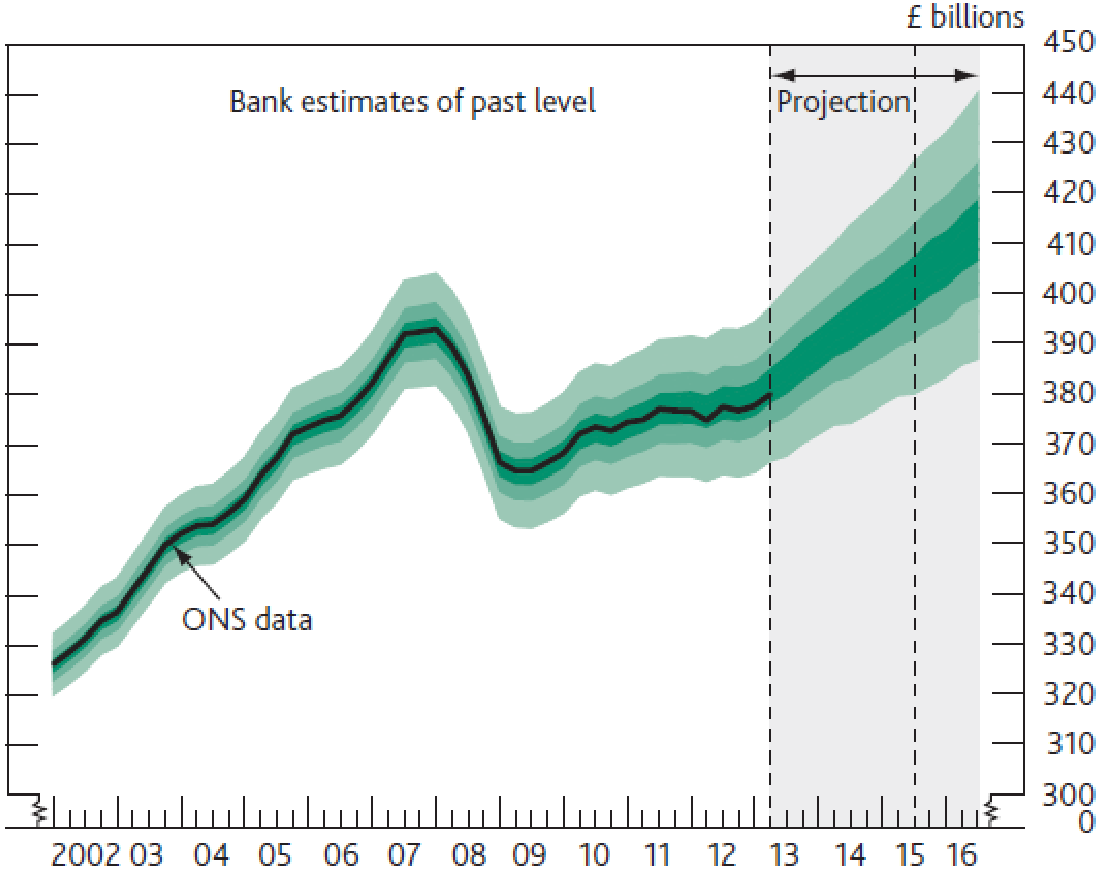
2013 Q1 output 1.5% lower than previously thought

Investment record more volatile than before



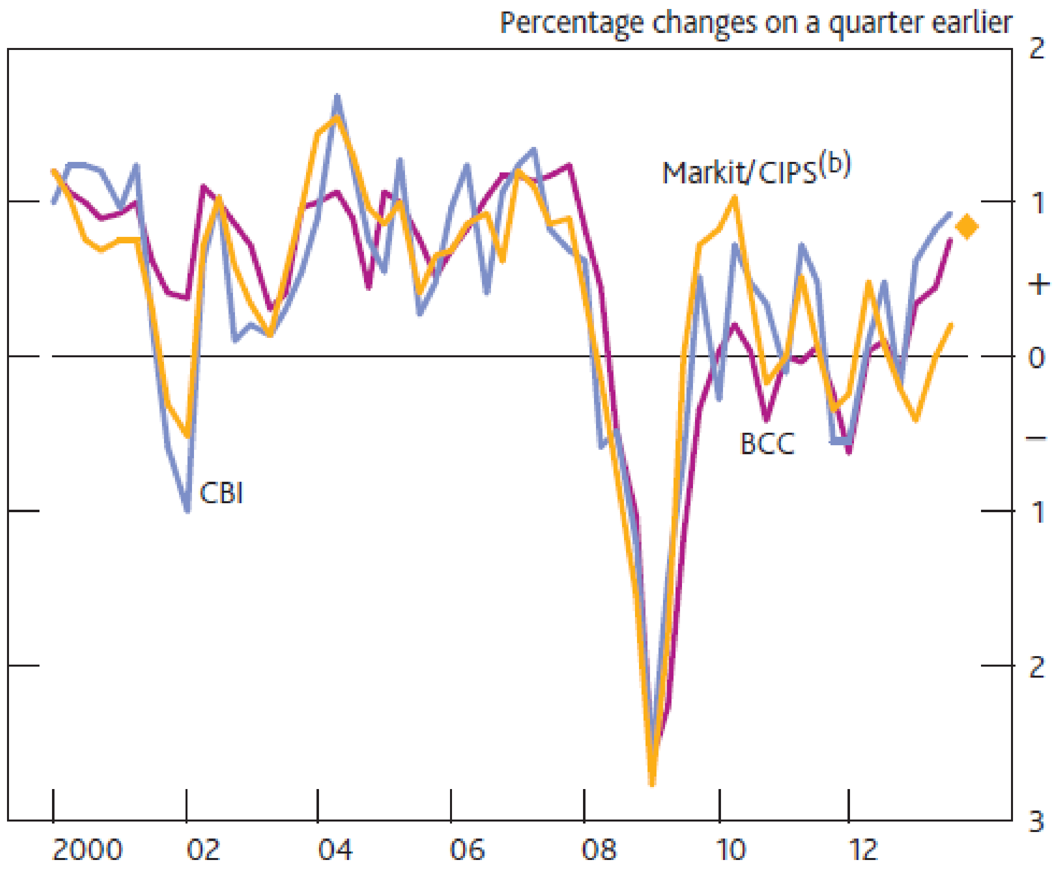
Sources: ONS and Bank calculations.

Projection of the level of GDP based on constant nominal interest rates at 0.5% and £375 billion asset purchases – still below peak output for another year



Surveys

Survey indicators of expected near-term growth in manufacturing and services output



Sources: BCC, CBI, CBI/PwC, Markit Economics, ONS and Bank calculations.

Survey news since publication of the August *Inflation Report*

CBI service sector survey Q3

- Total services business volumes balance rose to its highest level since Q4 2007.
- Total business optimism rose slightly to a record high, driven by rises in optimism in both business and professional services.

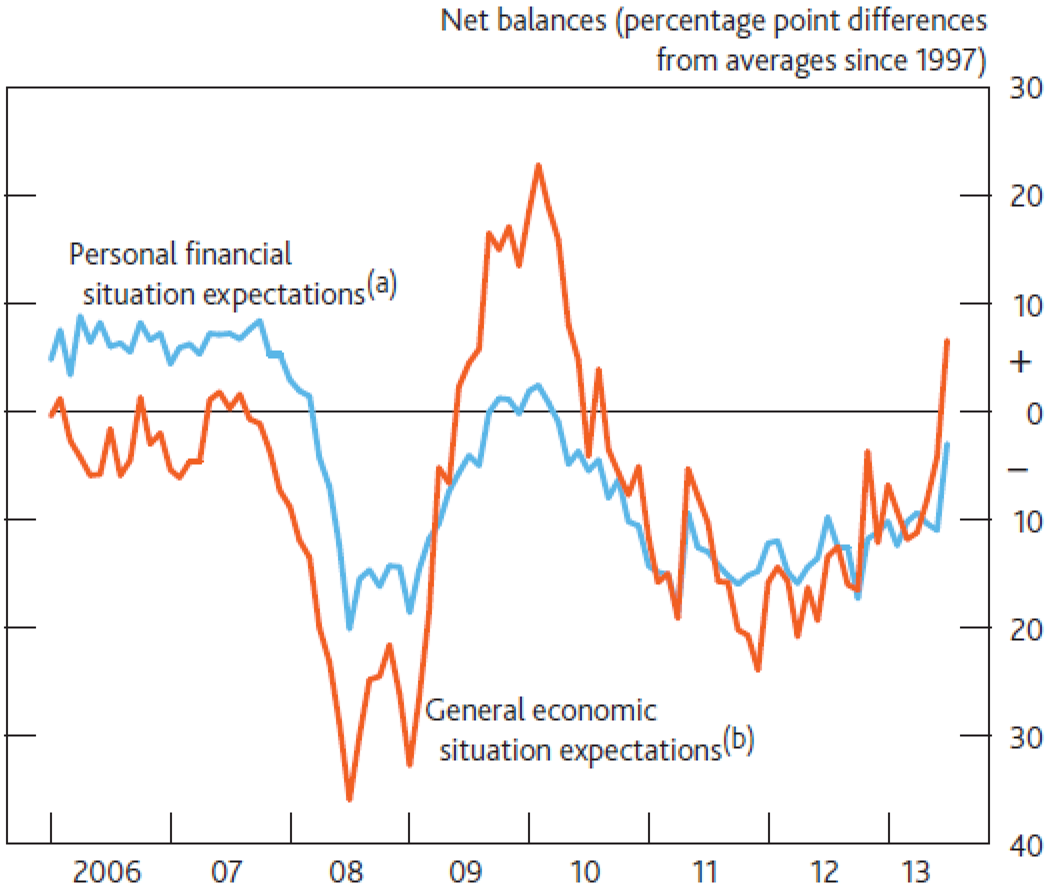
CBI monthly trends enquiry

- The balance of manufacturing firms expecting their volume of output to rise over the next three months rose to its highest level for over two years.

Markit/CIPS UK Construction PMI

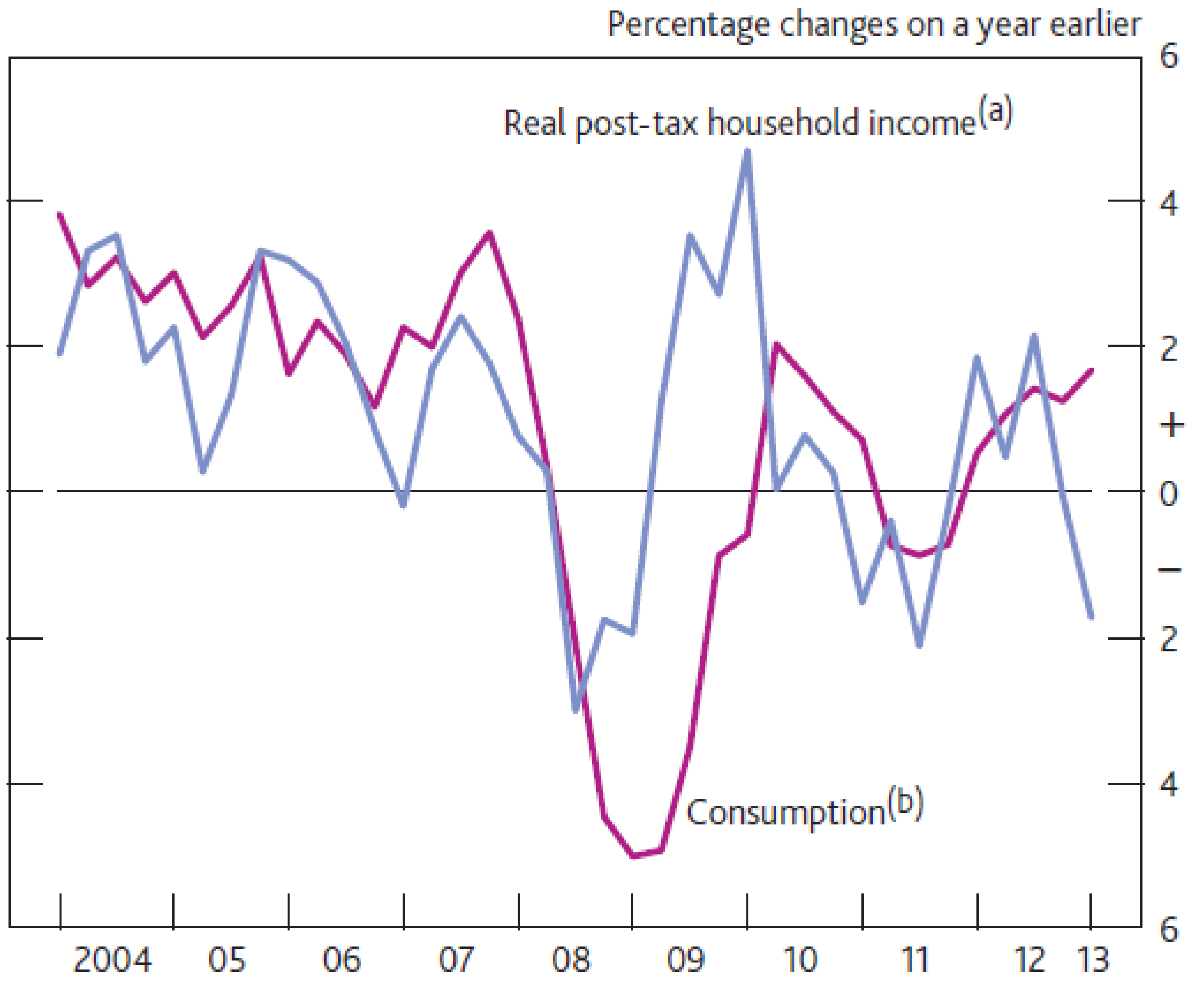
- Strongest construction output growth since June 2010, led by surge in housing activity.

Households’ personal financial and general economic situation expectations

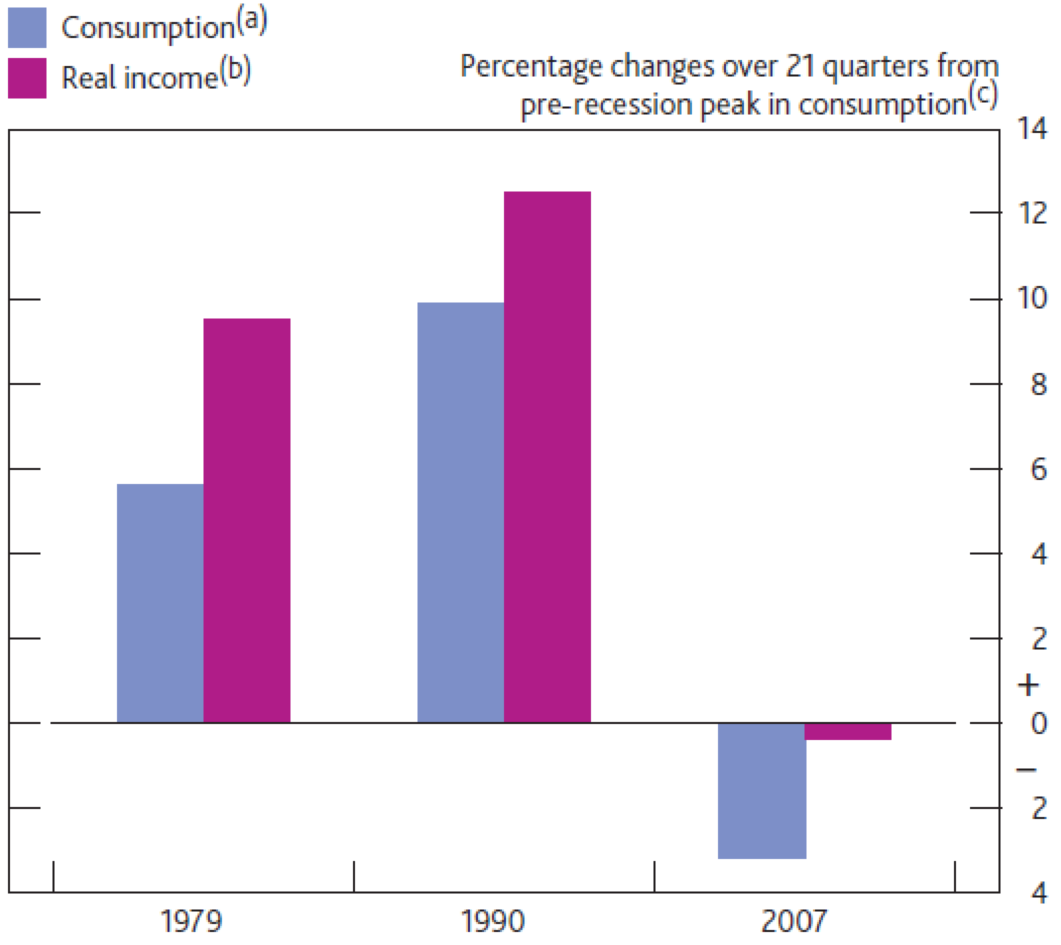


Source: Research carried out by GfK NOP on behalf of the European Commission.

Household consumption and real income

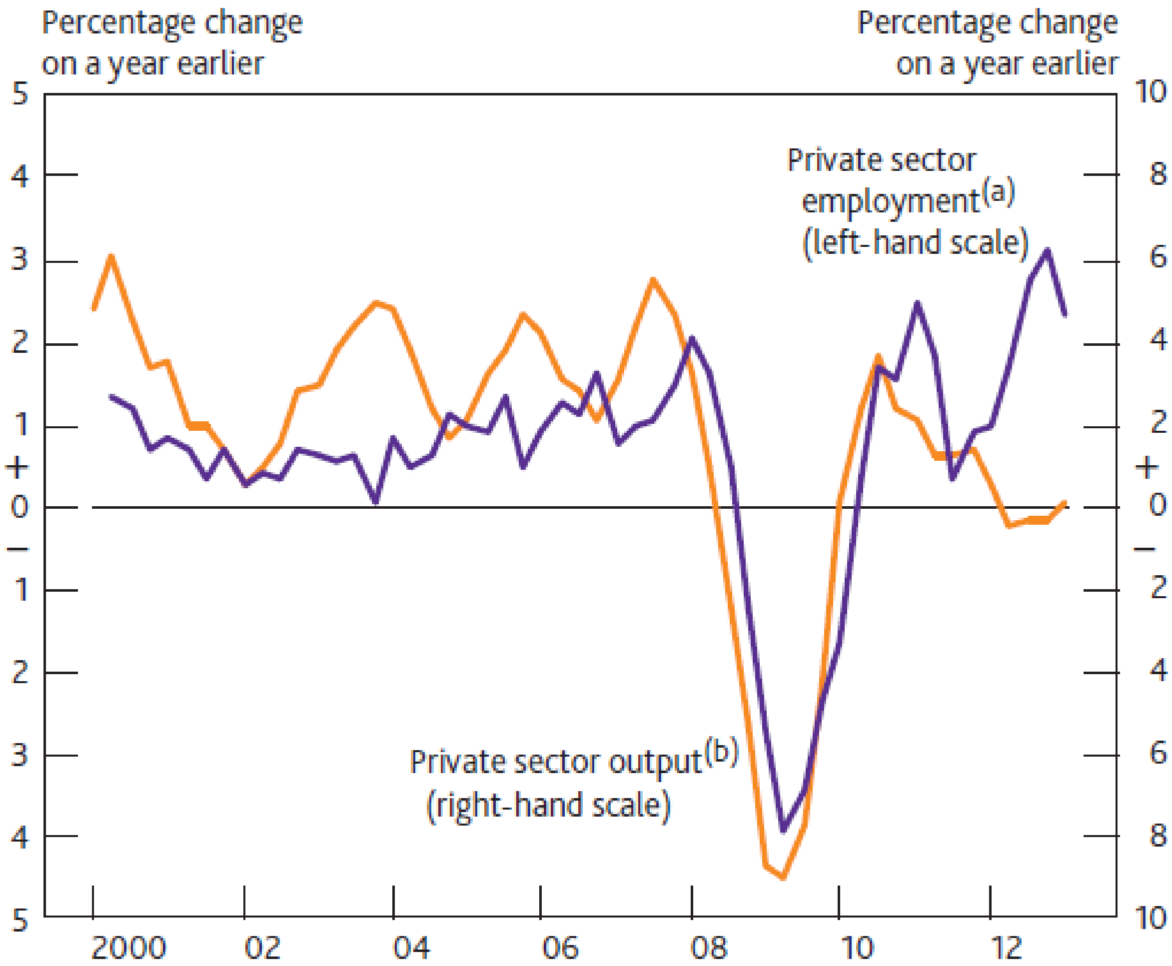


Household consumption and real income compared with previous recessions



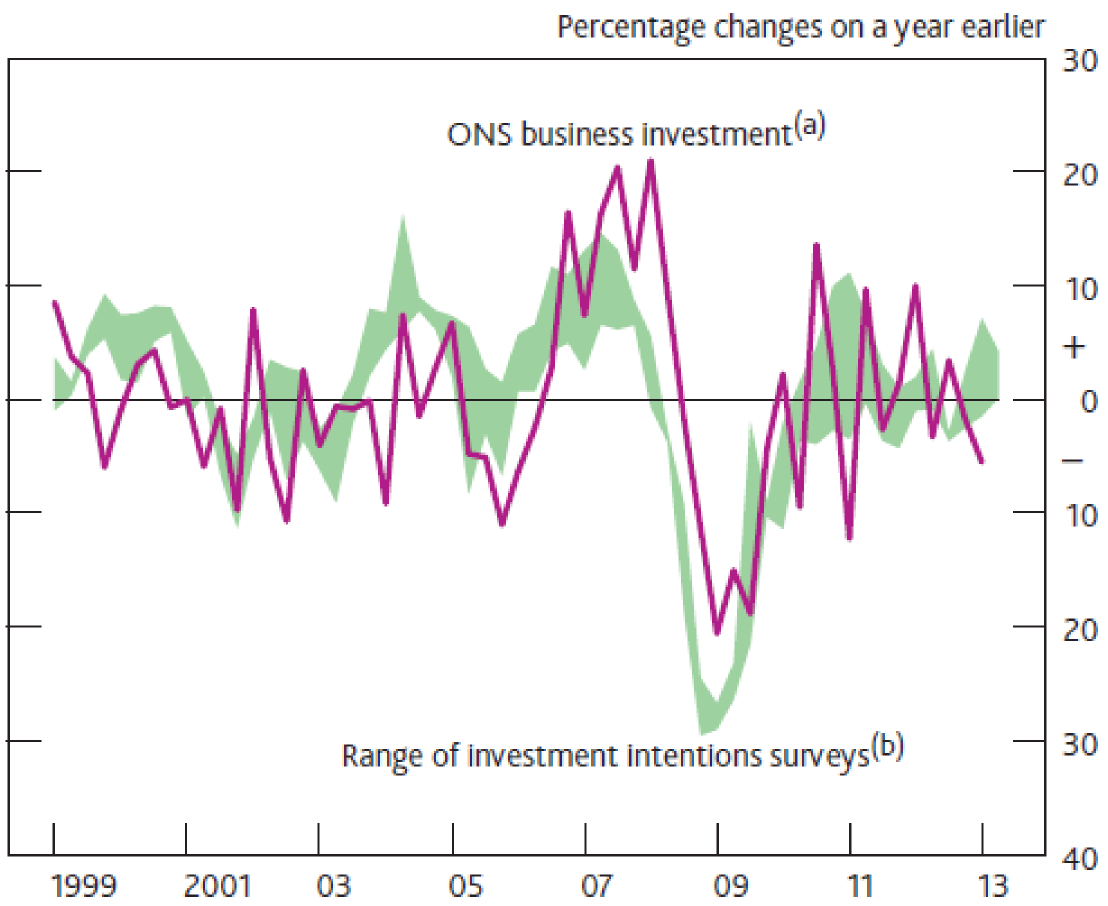
Household saving ratio

Private sector output and employment



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

Puzzle: Business investment and surveys of investment intentions



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

Business investment growth: MPC's view

- Given outstanding questions about the recent data revisions, MPC is placing less weight than usual on official history
- Even so, investment is likely to have been growing at below pre-crisis trend rate
- Growth is likely to be positive through the rest of 2013, albeit subdued

MPC Survey of UK Investment Intentions

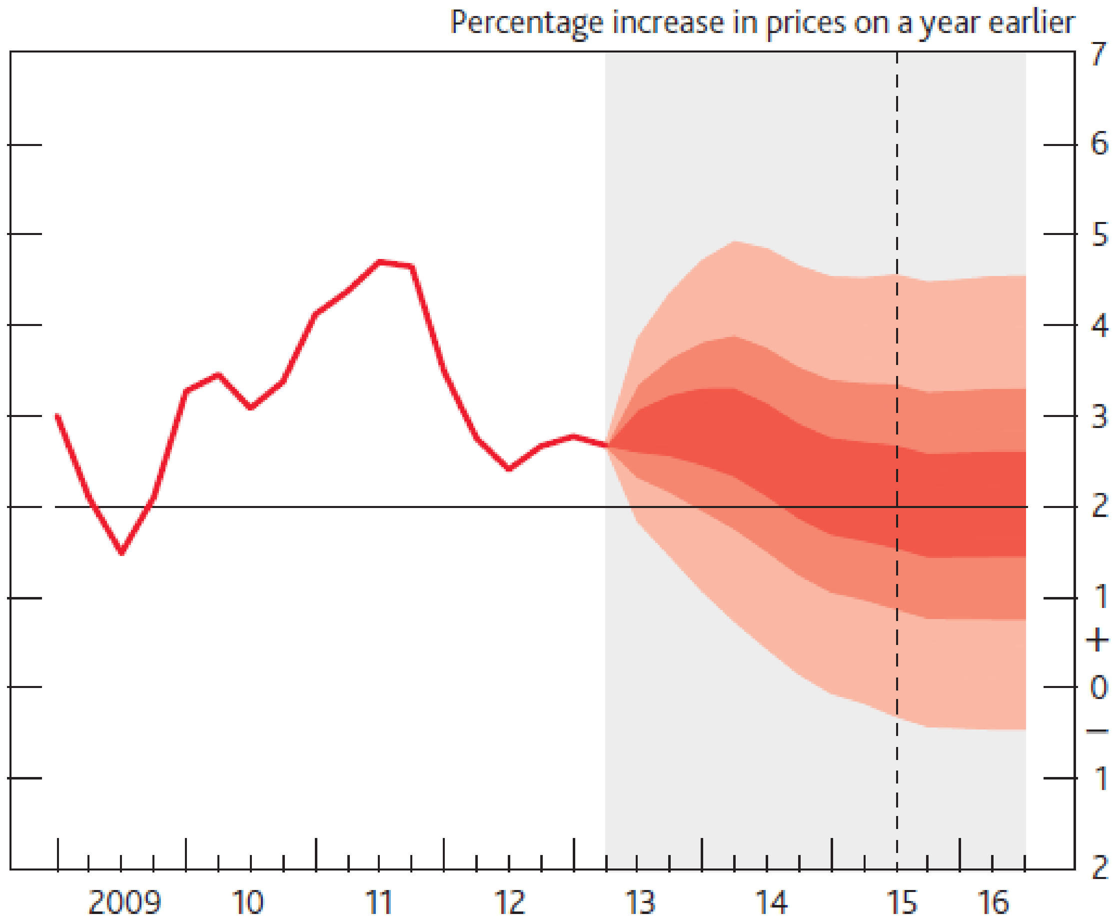
- Past12 months compared with the previous 12 months
- Next 12 months compared with the past 12 months

Inflation

Inflation projection

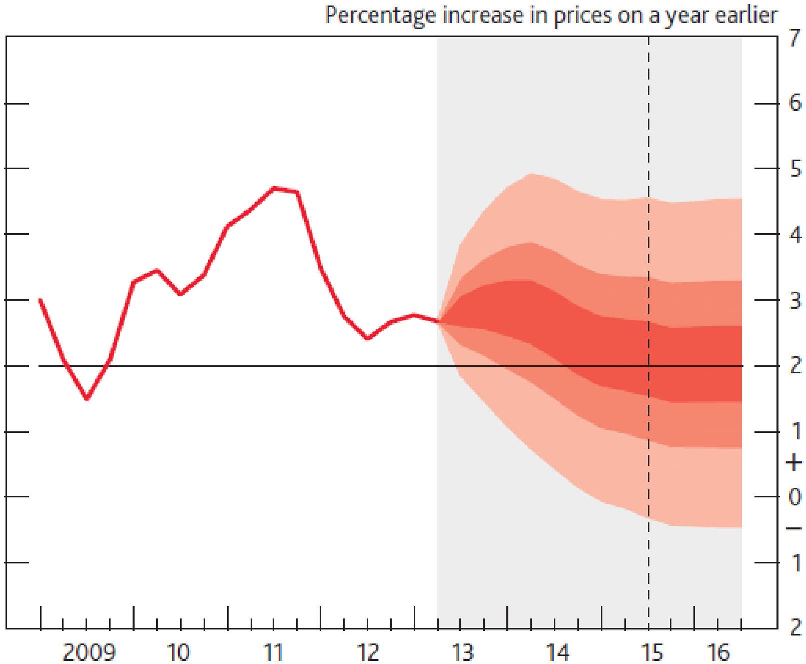
- Similar outlook to May's IR
- Continuing impact from past increases in import prices
- But external price pressures gradually fade
- The contribution from administered and regulated prices persists, gradually offset by a moderation in domestic cost pressures, aided by a revival in productivity growth

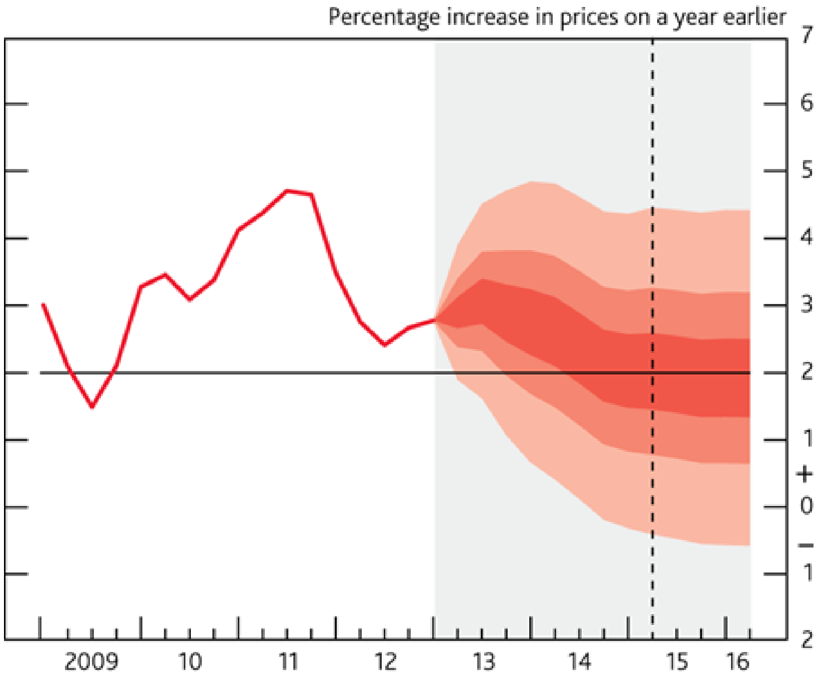
CPI inflation projection based on constant nominal interest rates at 0.5% and £375 billion asset purchases



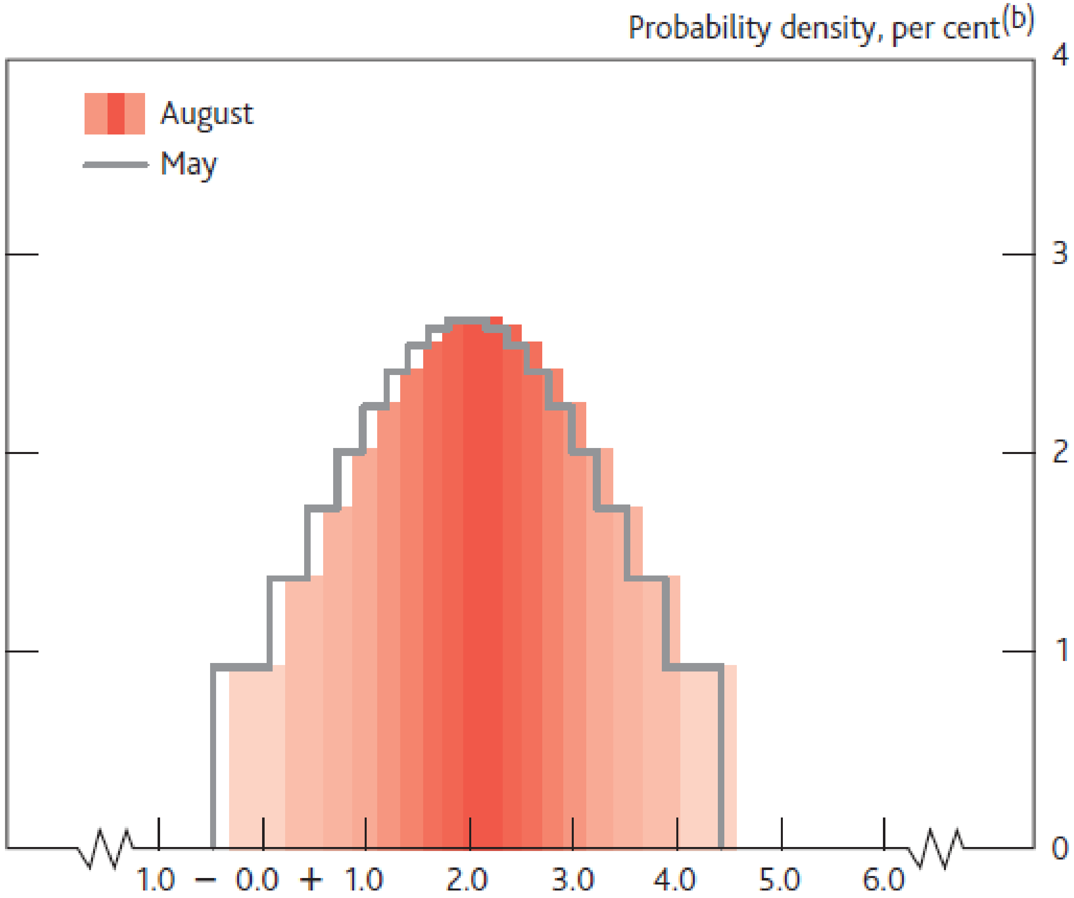
CPI inflation projection based on constant nominal interest rates at 0.5% and £375 billion asset purchases

August **May**





Projected probabilities of CPI inflation outturns in 2015 Q3 (central 90% of the distribution)

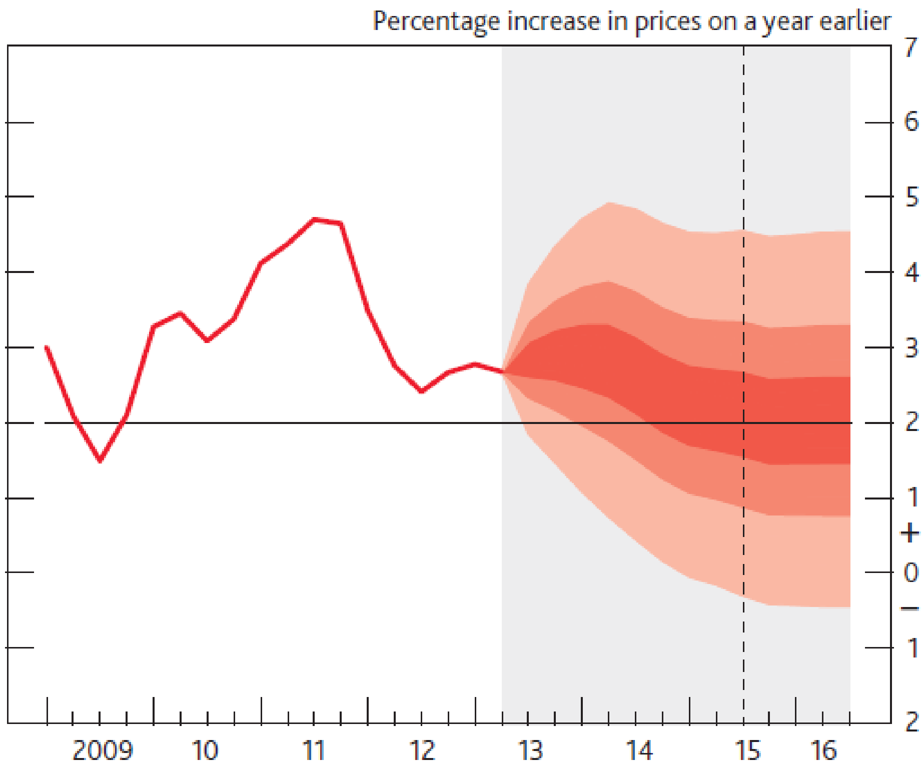


Inflation uncertainties

As demand accelerates, does productivity?

Will profit margins be restored more through higher prices or lower cost growth?

Sensitivity to commodity and exchange rate movements

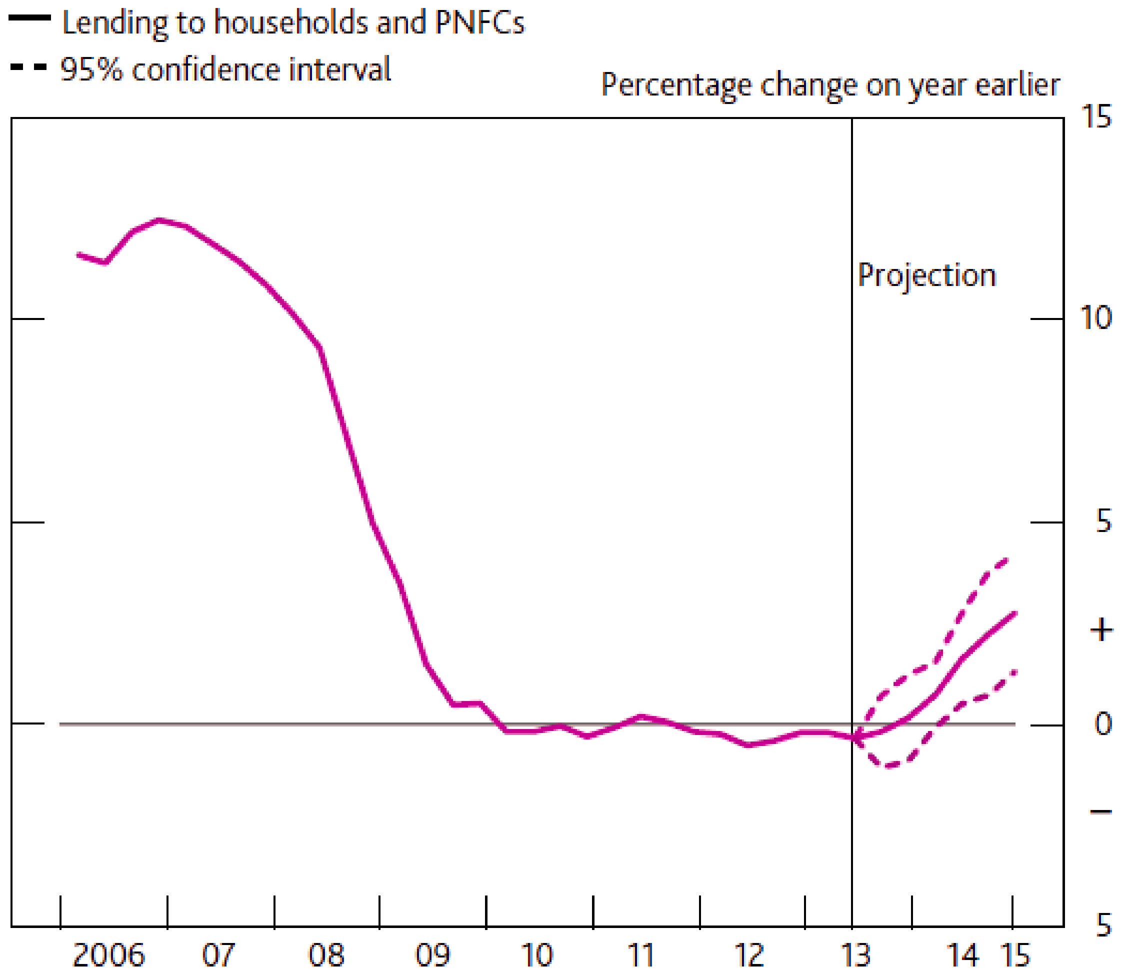


Credit conditions

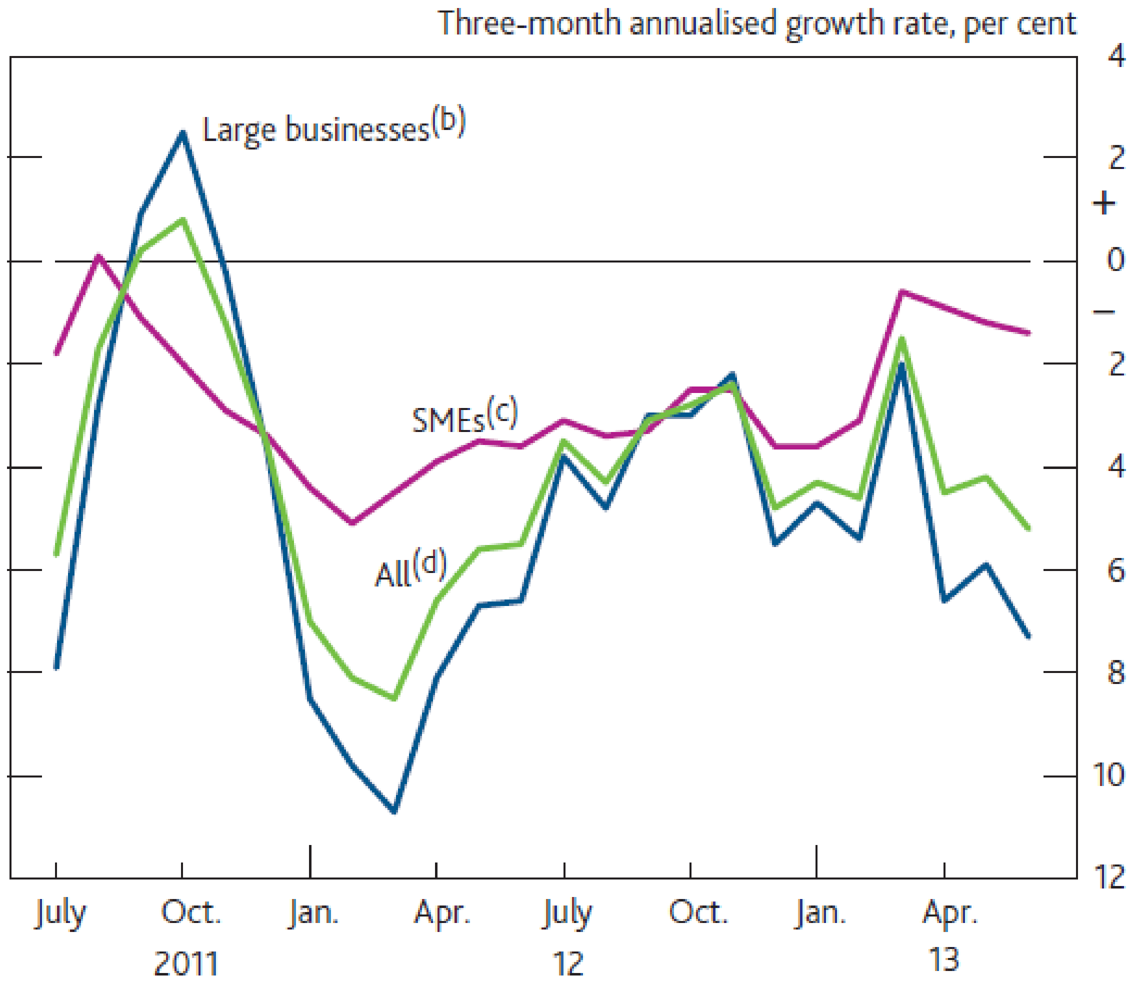
Credit conditions

- Bank funding costs - substantially lower since mid-2012
- Passing through as improved credit conditions for firms and households
- Non-bank forms of finance and weak demand may have affected bank lending growth
- Net lending expected to pick up and become modestly positive by end 2013
- Meanwhile, bank balance sheets are still under repair
- 7% capital threshold targets by end 2013, but £90Bn relaxation of liquidity cushions last week

Bank staff projection for loans to households and PNFCs[(a)]

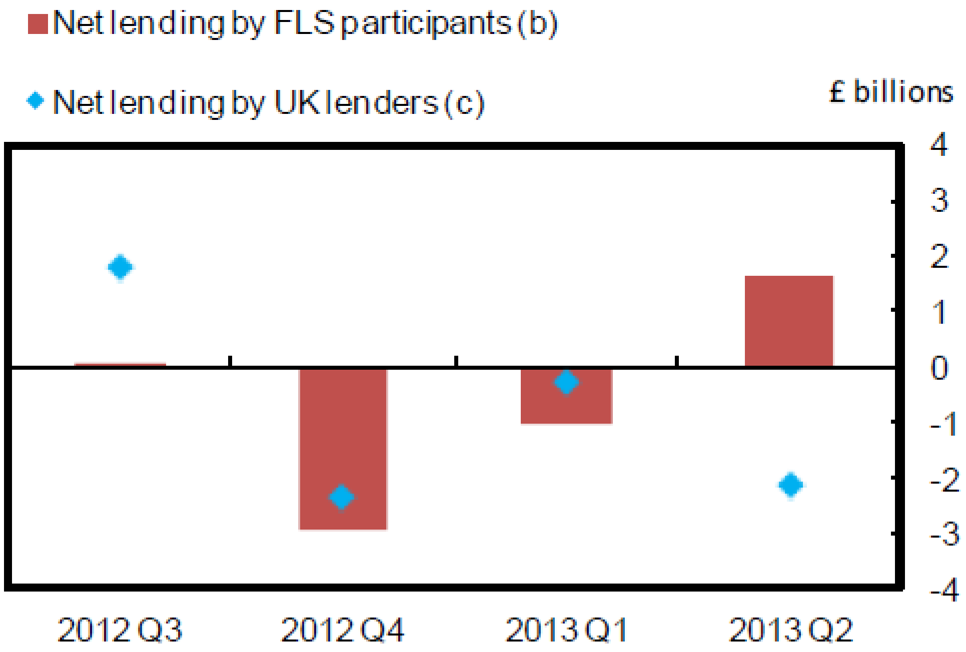


Lending to non-financial businesses by size



Memo: £17.6Bn outstanding drawings at 30.6.13

Chart 3: Net lending to UK households and businesses [(a)]

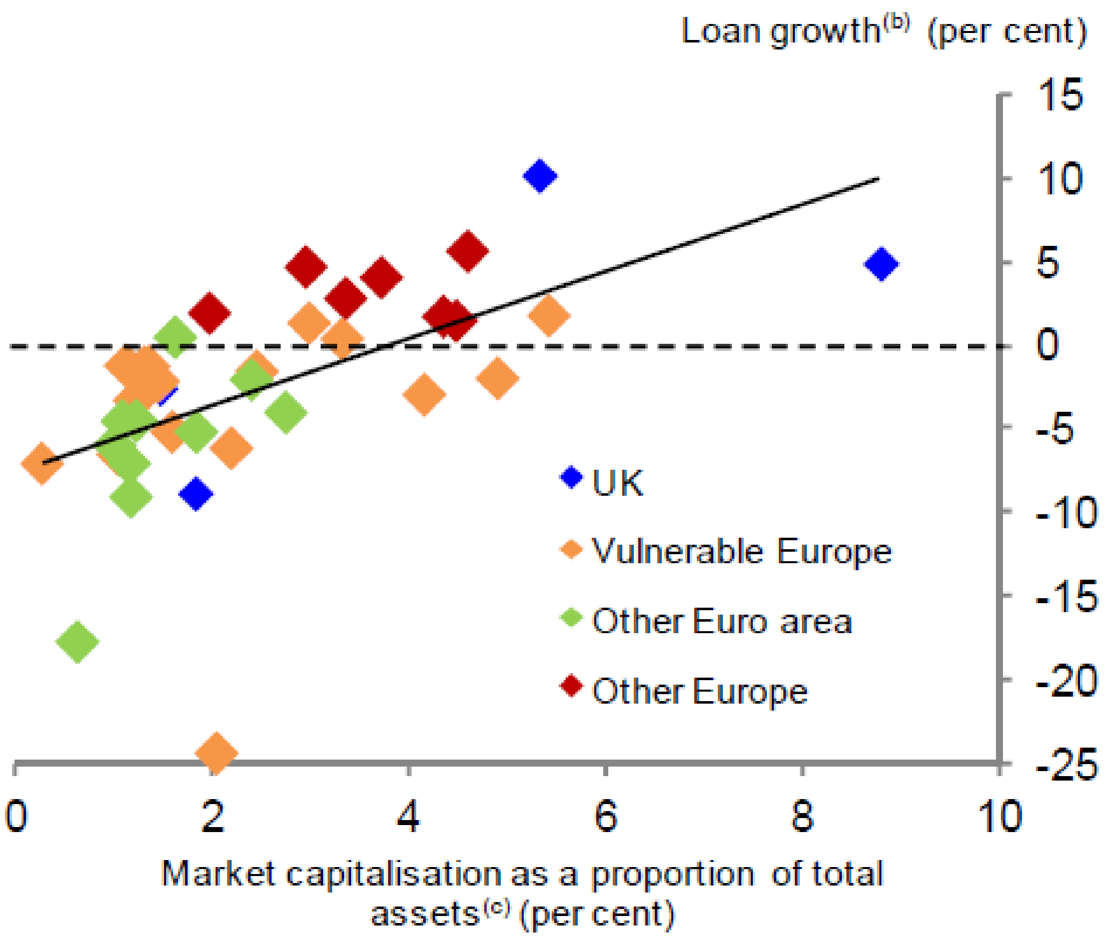


(a) Net flows of sterling lending by UK monetary financial institutions and related specialist mortgage lenders to the UK household sector and private non-financial corporations, excluding the effects of securitisations and loan transfers. Non seasonally adjusted.
(b) For 2013 Q2 includes lending to certain non-bank credit providers and eligible lending by those providers.
(c) Includes an estimated allocation of transit and suspense items, which is not included in FLS participants' lending data.

Cumulative net lending since 30/6/12 by FLS participants – principal reductions and increases

	£M			£M
Santander	-10,425		Barclays	7,492
RBS	-6,772		Nationwide BS	7,054
Lloyds	-5,338		Virgin Money	2,388
Bank of Ireland	-2,705		Coventry BS	2,135
Clydesdale	-1,624		Tesco Bank	1,522
Co-operative	-396		Aldermore	962
West Brom BS	-236		Leeds BS	781
Newcastle BS	-93		Skipton BS	638
Manchester BS	-40		Yorkshire BS	510
Mkt H, Marsden BS, each	-2		Metro Bank	281

Bank loan growth versus market capitalisation as a percentage of book value



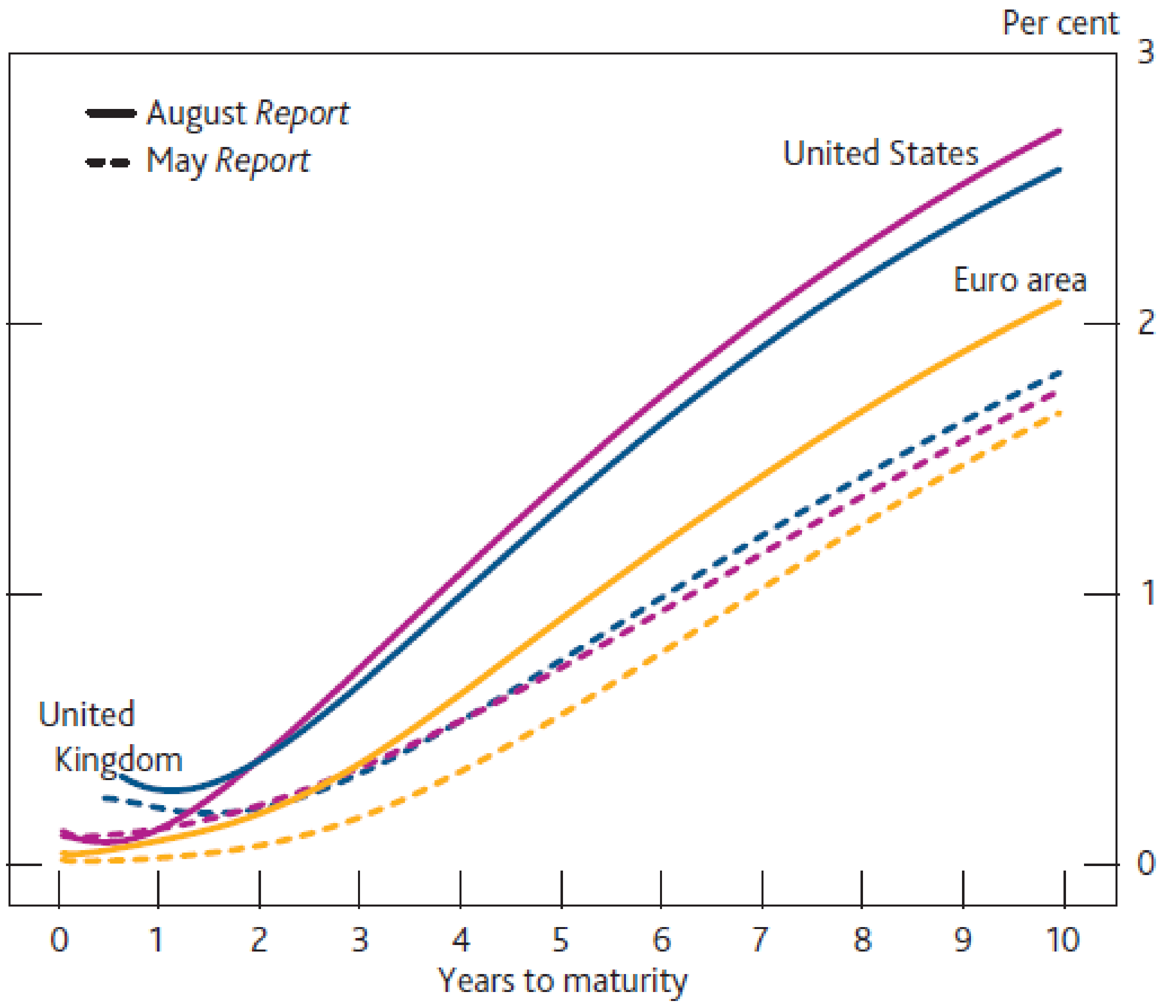
Sources: Bank of England, SNL Financial, Thomson Reuters Datastream, individual bank reports and Bank calculations.

MPC’s key assumptions

1. International policy initiatives facilitate a sustained, but gradual global recovery
2. Household and business spending recover as the consequences of the financial crisis slowly fade
3. The stronger demand outlook is largely matched by effective supply
4. A revival in productivity growth attenuates domestic cost pressures, such that inflation gradually returns to target as external price pressures fade.

Forward guidance

International forward interest rates



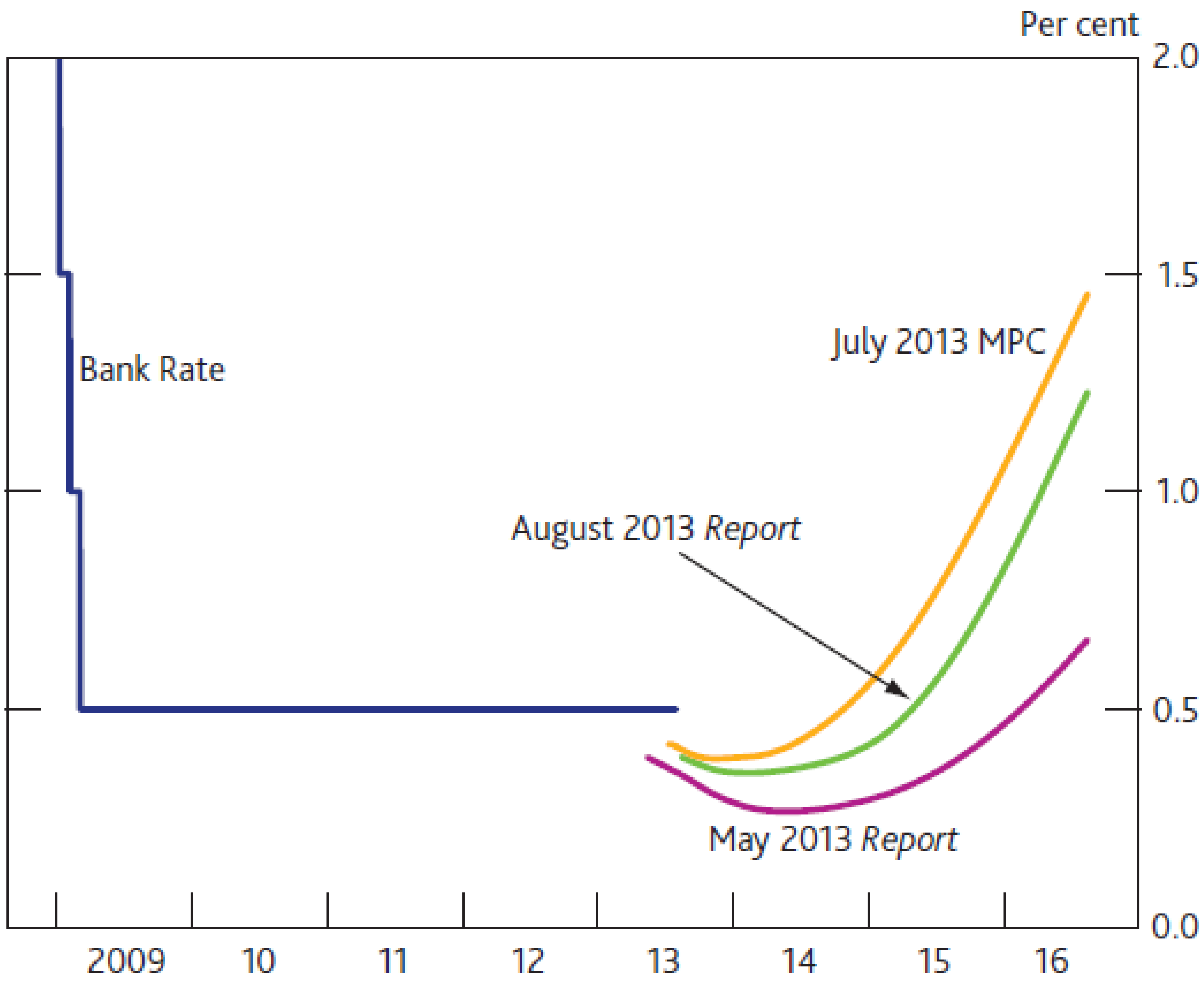
Sources: Bank of England and Bloomberg.

The minutes of July’s MPC meeting...

Market interest rates had risen sharply internationally and asset prices had been volatile and generally lower...

Taken in isolation, this increase in interest rates represented an unwelcome tightening in monetary conditions that, were it to persist, would risk hampering the emerging recovery. Given that, the Committee agreed that it was important to communicate that the implied rise in the expected future path of Bank Rate had not been warranted by the recent developments in the domestic economy.

Bank Rate and forward market interest rates



Sources: Bank of England and Bloomberg.

Forward guidance

- MPC intends, at a minimum, to maintain the current highly stimulative stance of monetary policy until economic slack has been substantially reduced, provided that:
  - it is consistent with price stability
  - does not endanger financial stability
- Until LFS unemployment rate falls to threshold of 7%, MPC intends:
  - not to raise Bank Rate
  - not to reduce the stock of asset purchases, and will undertake further purchases if additional stimulus warranted
  - to reinvest cash flows associated with maturing APF gilts

Forward guidance (cont.)

- This guidance ceases to be valid if any of the following three knockouts are breached:
  - more likely than not that CPI inflation 18-24 months ahead is 0.5pp or more above 2% target
  - medium-term inflation expectations no longer sufficiently well anchored
  - FPC judges stance of monetary policy poses a threat to financial stability that cannot be otherwise contained

Aims of forward guidance

- To enhance effectiveness of monetary policy by:
  - providing greater clarity about MPC's view of appropriate trade-off between returning inflation to target and supporting the recovery
  - reducing uncertainty about path of monetary policy as economy recovers (and in particular avoiding premature increases in market rates)
  - delivering a robust framework to explore scope for expansion without risking price and financial stability

Alternative indicators

- MPC considered guidance linked to a variety of other possible indicators:
  - Threshold: nominal GDP growth; nominal GDP shortfall; output gap; real GDP growth; employment rate
  - Unemployment particularly attractive when there is uncertainty about how productivity will respond to demand
  - Price stability knockout: current inflation; 'core' inflation
- See document released on 7 August for further discussion of these alternatives

Knockouts

The guidance linking Bank Rate and asset sales to the unemployment threshold would cease to hold if any of the following three "knockouts" were breached:

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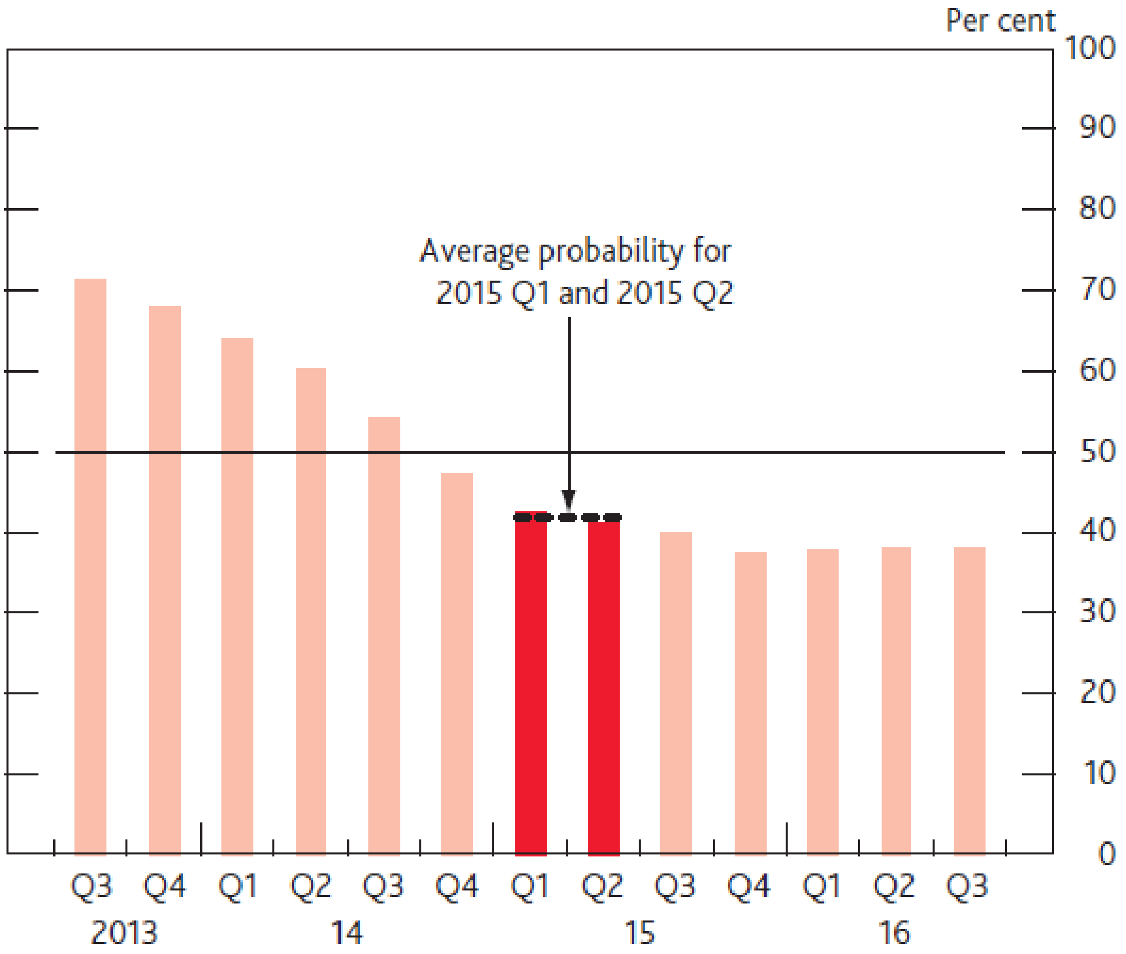
The guidance linking Bank Rate and asset sales to the unemployment threshold would cease to hold if any of the following three “knockouts” were breached:

- in the MPC’s view, it is more likely than not, that CPI inflation 18 to 24 months ahead will be 0.5 percentage points or more above the 2% target

Probability that CPI inflation will be at or above the 2.5% knockout



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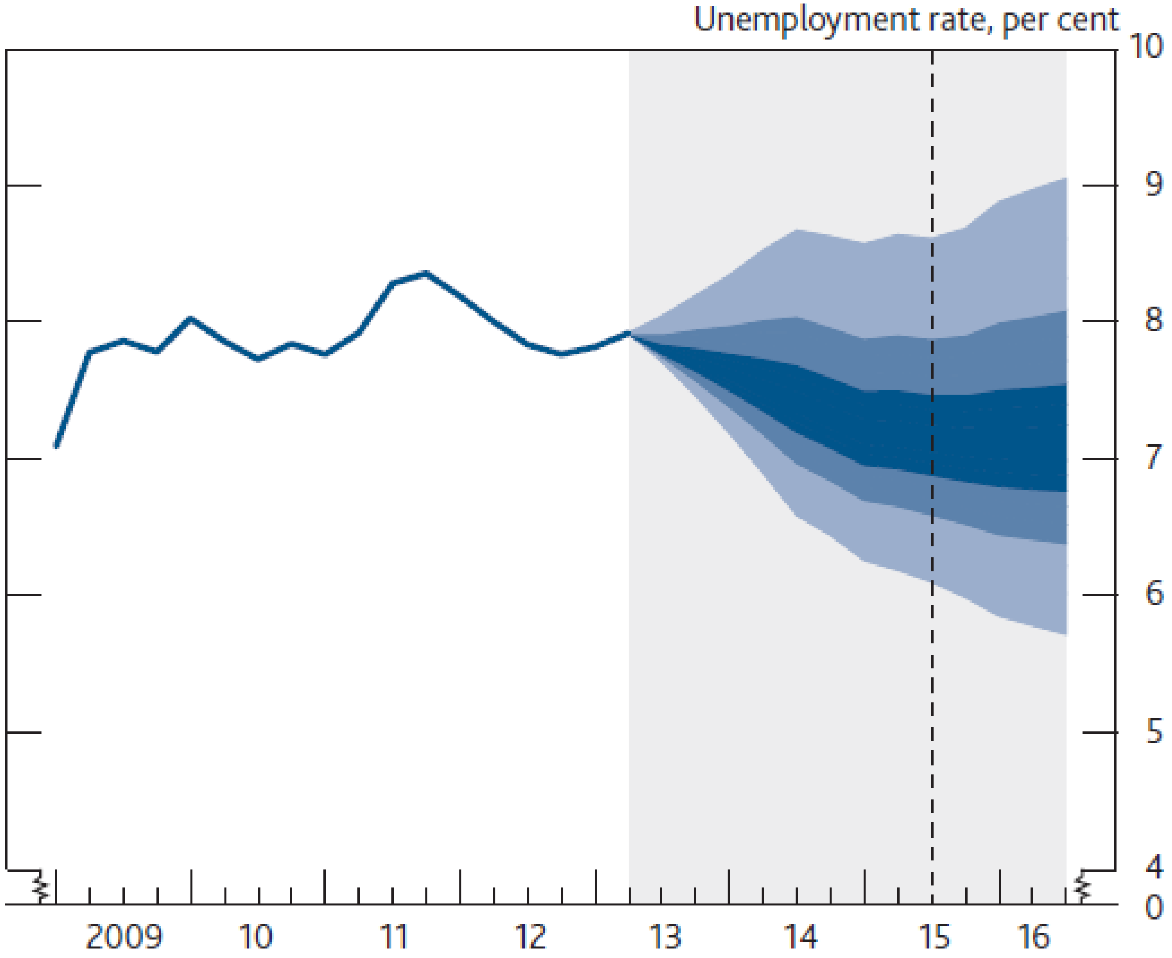
- medium-term inflation expectations no longer remain sufficiently well anchored

- the Financial Policy Committee (FPC) judges that the stance of monetary policy poses a significant threat to financial stability that cannot be contained by the substantial range of mitigating policy actions available to the FPC, the Financial Conduct Authority and the Prudential Regulation Authority in a way consistent with their objectives.

Monthly MPC meetings

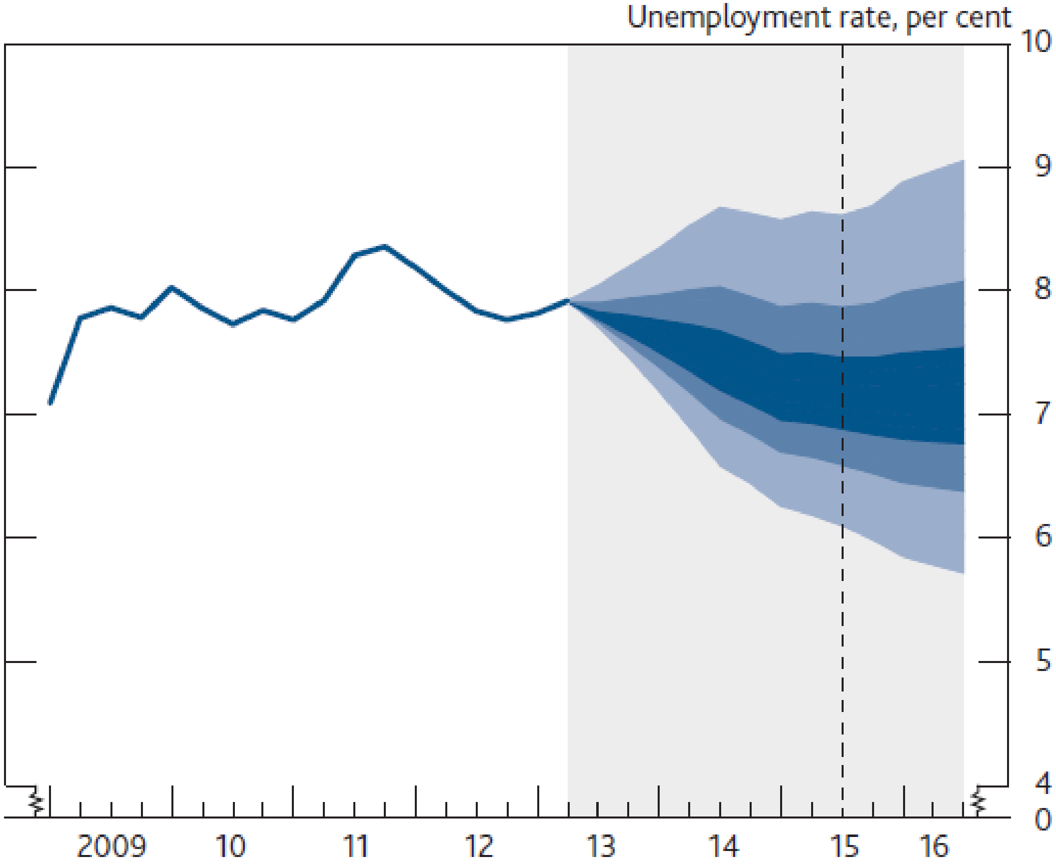
- MPC will continue to vote on Bank Rate and size of asset purchase program
  - will depend on individual members' assessments of whether the knockouts have been breached
- No presumption that reaching unemployment threshold or breaching a price or financial stability knockout triggers an immediate increase in Bank Rate
  - will depend on MPC's assessment of outlook at the time and what is required to achieve its remit
  - may or may not involve issuance of further guidance

Unemployment projection based on constant nominal interest rates at 0.5% and £375 billion asset purchases

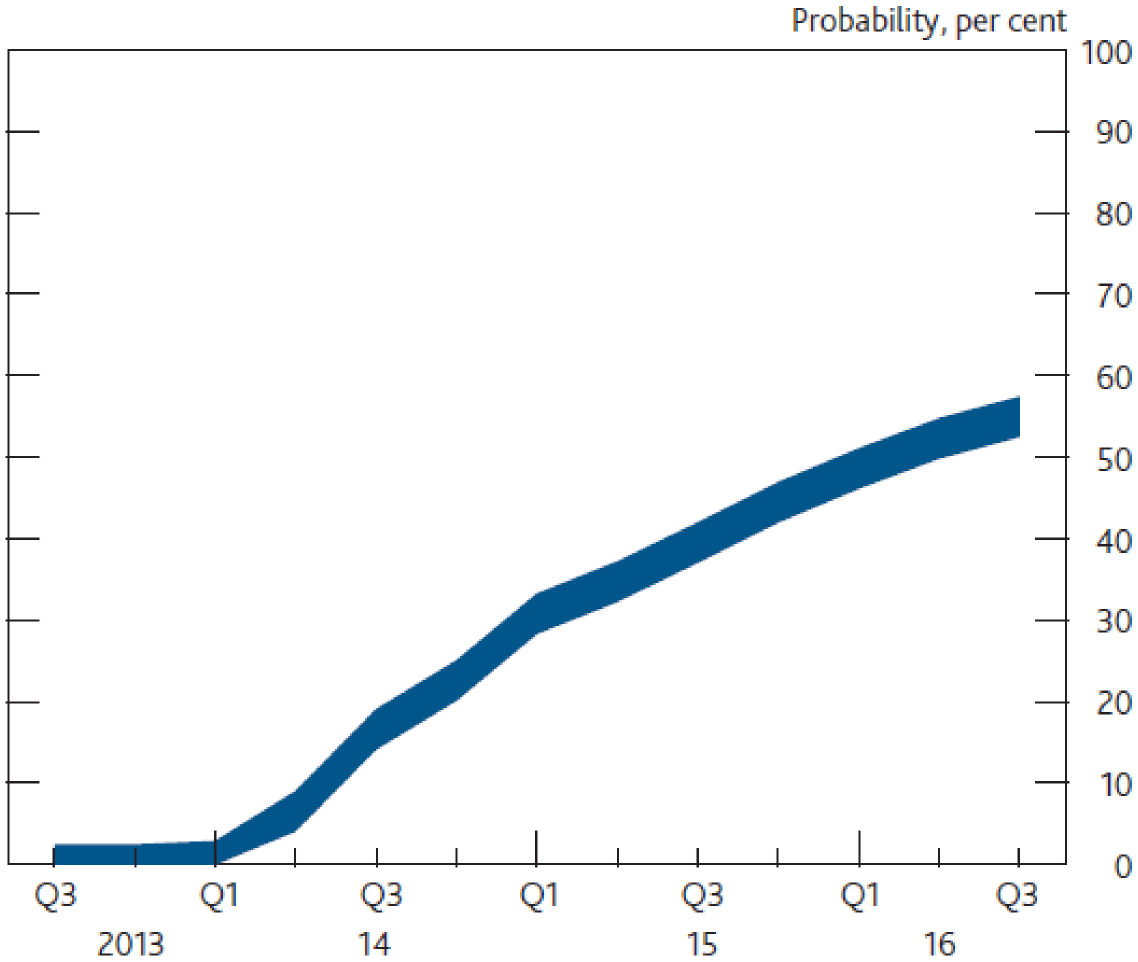


Unemployment projection based on constant nominal interest rates at 0.5% and £375 billion asset purchases

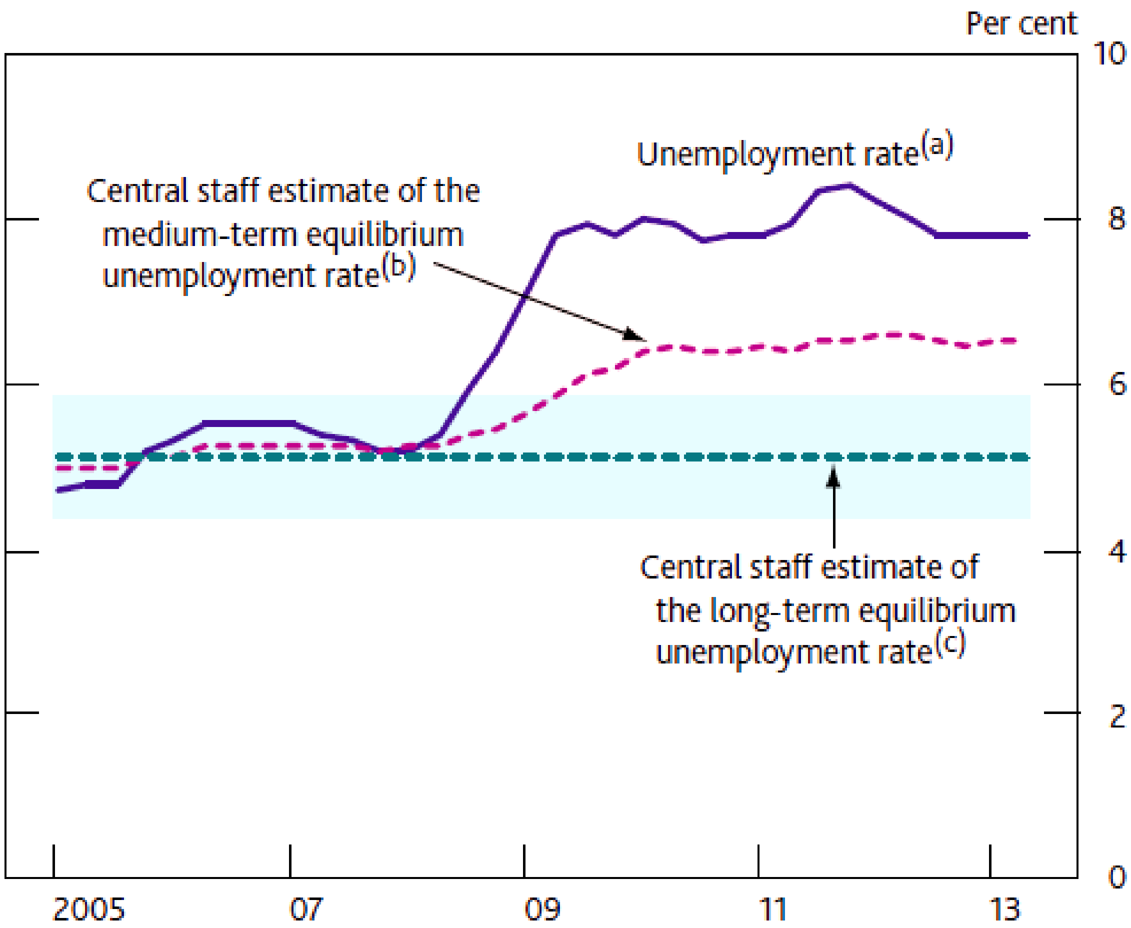
MPC's best collective judgement: 7.3% at the end of the forecast period



Cumulative probability of unemployment having fallen below the 7% threshold



The unemployment rate and measures of the equilibrium unemployment rate



7.8%

6.5%

>5%

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What significance might this forward guidance have for your business?

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