



BANK OF ENGLAND

Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 4 August 2020

Publication date: 6 August 2020

These are the minutes of the Monetary Policy Committee meeting ending on 4 August 2020.

They are available at <https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2020/august-2020>.

The Bank of England Act 1998 gives the Bank of England operational responsibility for setting monetary policy to meet the Government's inflation target. Operational decisions are taken by the Bank's Monetary Policy Committee. The minutes of the Committee meeting ending on 16 September will be published on 17 September 2020.

Monetary Policy Summary, August 2020

The Bank of England's Monetary Policy Committee (MPC) sets monetary policy to meet the 2% inflation target, and in a way that helps to sustain growth and employment. In that context, its challenge at present is to respond to the economic and financial impact of the Covid-19 pandemic. At its meeting ending on 4 August 2020, the MPC voted unanimously to maintain Bank Rate at 0.1%. The Committee voted unanimously for the Bank of England to continue with its existing programmes of UK government bond and sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, maintaining the target for the total stock of these purchases at £745 billion.

The Committee's projections for activity and inflation are set out in the accompanying *August Monetary Policy Report*. Although recent developments suggest a less weak starting point for the Committee's latest projections, it is unclear how informative they are about how the economy will perform further out. The outlook for the UK and global economies remains unusually uncertain. It will depend critically on the evolution of the pandemic, measures taken to protect public health, and how governments, households and businesses respond to these factors. The MPC's projections assume that the direct impact of Covid-19 on the economy dissipates gradually over the forecast period. Given the inherent uncertainties regarding the evolution of the pandemic, the MPC's medium-term projections are a less informative guide than usual.

Global activity has strengthened over recent months, although it generally remains below its level in 2019 Q4. Covid-19 has continued to spread rapidly within a number of emerging market economies, however, and there has been a renewed rise in cases in many advanced economies.

UK GDP is expected to have been over 20% lower in 2020 Q2 than in 2019 Q4. But higher-frequency indicators imply that spending has recovered significantly since the trough in activity in April. Payments data suggest that household consumption in July was less than 10% below its level at the start of the year. Housing market activity appears to have returned to close to normal levels, despite signs of a tightening in credit supply for some households. There is less evidence available on business spending, but surveys suggest that business investment is likely to have fallen markedly in Q2 and investment intentions remain very weak.

Employment appears to have fallen since the Covid-19 outbreak, although this has been very significantly mitigated by the extensive take-up of support from temporary government schemes. Surveys indicate that many workers have already returned to work from furlough, but considerable uncertainty remains about the prospects for employment after those support schemes unwind. In the near term, the unemployment rate is projected to rise materially, to around 7½% by the end of the year, consistent with a material degree of spare capacity.

In the MPC's central projection, GDP continues to recover beyond the near term, as social distancing eases and consumer spending picks up further. Business investment also recovers, but somewhat more slowly. Unemployment declines gradually from the beginning of 2021 onwards. Activity is supported by the substantial fiscal and monetary policy actions in place. Nonetheless, the recovery in demand takes time as health concerns drag on activity. GDP is not projected to exceed its level in 2019 Q4 until the end of 2021, in part reflecting persistently weaker supply capacity. Given the scale of the movements in output, as well as the inherent uncertainty over the factors determining the outlook, the evolution of the balance between demand and supply is hard to assess. The MPC's central projection implies that a margin of spare capacity is likely to remain until the end of next year. The risks to the outlook for GDP are judged to be skewed to the downside.

Twelve-month CPI inflation increased to 0.6% in June from 0.5% in May. CPI inflation is expected to fall further below the 2% target and average around ¼% in the latter part of the year, largely reflecting the direct and indirect effects of Covid-19. These include the impact of energy prices and the temporary cut in VAT for hospitality, holiday accommodation and attractions. As these effects unwind, inflation rises, supported by a gradual strengthening of domestic price pressures as spare capacity diminishes. In the MPC's central projection, conditioned on prevailing market yields, CPI inflation is expected to be around 2% in two years' time.

The Committee will continue to monitor the situation closely and stands ready to adjust monetary policy accordingly to meet its remit. The MPC will keep under review the range of actions that could be taken to deliver its objectives. The Committee does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% inflation target sustainably.

At this meeting, the Committee judges that the existing stance of monetary policy remains appropriate.

Minutes of the Monetary Policy Committee meeting ending on 4 August 2020

1 Before turning to its immediate policy decision, and against the backdrop of its latest economic projections, the Monetary Policy Committee (MPC) discussed: the international economy; financial markets; credit conditions and monetary developments; demand and output; and supply, costs and prices.

The international economy

2 There had been a sharp fall in global activity in 2020 Q2, albeit smaller than had been anticipated at the time of the MPC's previous meeting. Bank staff estimated that UK-weighted world GDP had fallen by around 9% in Q2, significantly larger than any quarterly fall recorded during the global financial crisis, leaving it around 12% below its pre-Covid level in 2019 Q4. There had been a partial recovery in May and June as restrictions in most economies had been eased. There were signs that consumer spending had picked up less quickly in areas where infection rates were rising.

3 According to the preliminary flash estimate, euro-area GDP had fallen by 12.1% in 2020 Q2, leaving it around 15% below its pre-Covid level. GDP had fallen materially in Q2, by more than 10% in Germany, France and Italy, and by nearly 20% in Spain. Euro-area activity indicators had recovered in May, with retail sales picking up faster than industrial production, but had remained below their February levels. The unemployment rate had ticked up slightly in June, to 7.8%, but the rise in unemployment continued to be limited by the unprecedented uptake of employment support schemes and lower workforce participation. Covid-related restrictions on economic activity had continued to be lifted across most of the euro area, although some localised restrictions had been re-imposed in July. Nearly all euro-area countries had experienced a rise in new Covid-19 cases in recent weeks. Nevertheless, indicators of economic mobility and spending on social consumption, and business surveys, had continued to improve, suggesting that euro-area GDP would return to positive growth in Q3.

4 At the time of the MPC's previous meeting, the European Commission (EC) had proposed a new recovery fund, Next Generation EU, totalling €750 billion. This had since been agreed by the European Union and was to be divided roughly equally between grants and loans to member states, financed by EC bonds and distributed from 2021 to 2023. Subsequently, the French government had outlined a €100bn domestic recovery plan, spread over 2021-22, partly financed by the EU recovery fund. The Italian government had agreed a further €25bn spending package that would extend measures to support furloughed workers, local administrations, and sectors that had been particularly affected by the pandemic such as car manufacturing and tourism.

5 US GDP had fallen by 9.5% in 2020 Q2, according to the advance estimate, leaving it around 11% below its pre-Covid level. US retail sales had recovered to their pre-Covid level in June, but industrial production had remained relatively weak. Non-farm payrolls had increased by almost five million in June, substantially exceeding expectations. The unemployment rate had declined, to 11.1% from 13.3% in May. As had been the

case in April and May, the Bureau of Labour Statistics had noted that these figures probably under-estimated somewhat the official unemployment rate, as some workers affected by Covid-related business closures had been misclassified as employed but absent from work. The wider U-6 measure of workforce underutilisation had risen, to 18% in June. The Paycheck Protection Program was continuing to support small businesses, encouraging them to retain or re-employ workers. Congressional negotiations were continuing about the possibility of a further fiscal support package.

6 In recent weeks, a range of more timely indicators, including credit card data and initial jobless claims, had pointed to a slowing in the US recovery as the number of Covid-19 cases had picked up sharply across a number of large states. Easing of restrictions on economic activity had been paused or reversed in around 60% of the United States by population. According to the Conference Board, consumer confidence had declined in July following a large gain in June. Reflecting these developments, Bank staff expected the United States to return to positive growth in 2020 Q3, but to a lesser degree than in the euro area.

7 According to the National Bureau of Statistics, GDP in China had increased by 11.5% in 2020 Q2, a significantly larger rise than had been anticipated at the time of the MPC's previous meeting. Consequently, Chinese GDP had recovered to a little above its level at the end of 2019. The recovery in China had been strong but uneven. Annual industrial production growth had reached 4.8% in June, close to the average rate seen in 2019. There had also been a broad-based recovery in Chinese exports during Q2, after falling across most trading partners in Q1, resulting in a large positive trade balance. Annual retail sales growth had been slower to recover and remained slightly negative in June.

8 Covid-19 had continued to spread rapidly across many emerging market economies outside China, including Brazil, India and Russia. There were tentative signs of a recovery in economic activity in some of these economies, as industrial production and retail sales had increased in May, although activity had fallen or remained flat in others. In general, these indicators had remained substantially below their end-2019 levels.

9 Oil prices had risen further over recent weeks, reflecting positive news on economic activity. The Brent spot price was now \$43 per barrel compared with around \$20 at its trough and around \$65 at the beginning of this year.

10 Euro-area twelve-month HICP inflation had increased to 0.4% in July, according to the flash estimate, while core inflation, excluding energy, food, alcohol and tobacco, had increased to 1.2%. In the United States, PCE inflation had also increased, to 0.8% in June, while core PCE inflation had eased to 0.9%, from 1.0% in May.

Financial markets

11 Since the MPC's previous meeting, global risk sentiment had been fairly stable, although volatility had remained elevated. Government bond yields in major advanced economies had declined further, while liquidity conditions and functioning in those markets had remained broadly normal, following the turbulence seen in March.

12 Movements in major global equity price indices had been mixed since the MPC's June meeting, while corporate bond spreads had continued to tighten. The S&P 500 had continued to increase and had now recovered almost all of the fall seen from its peak in February to the lows in March, although this had been accentuated by the relatively high weight accounted for by certain large, high-performing firms.

13 More generally, market contacts had reported that investors remained cautious. Measures of equity market implied volatility, such as the VIX, had remained above historical averages, and market pricing suggested that the VIX was expected to remain at elevated levels over the rest of the year, with a particular focus on the US presidential election. Perceived downside risks had not receded materially, with options prices suggesting that investors continued to demand higher-than-usual compensation for the risk of a sharp fall in equity prices over the next six months.

14 Advanced economy short and long-term government bond yields had fallen since the MPC's previous meeting, and market pricing implied that rates were expected to remain at low levels. The ECB Governing Council had left policy unchanged at its 16 July meeting. At its meeting on 29 July, the Federal Open Market Committee had left unchanged both the target range for the federal funds rate and its forward guidance concerning policy rates and asset purchases.

15 In the United Kingdom, short-rate expectations had fallen to a somewhat greater degree than in other countries, and the yield curve had steepened. Three-year instantaneous forward Overnight Index Swap rates had fallen to -0.1%, 16 basis points lower than at the time of the Committee's previous meeting, and 33 basis points below the 15-day average in the run-up to the May *Monetary Policy Report*. Market contacts reported that this had reflected the interaction of several factors. In particular, contacts had pointed to recent communications from MPC members about reviewing the monetary policy toolkit, including the possibility of setting a negative Bank Rate. This was consistent with the negative tails from option-price-implied interest rate distributions having widened. In addition, market participants had started to pay greater attention to downside risks to the UK's economic recovery, which had also pushed down on short-term rates. The MPC was not expected to adjust monetary policy at this meeting.

16 The sterling effective exchange rate index had been little changed since June. This had primarily reflected offsetting moves in other major currencies, notably a steady appreciation in the euro, supported by growing confidence that the EU's recovery fund would be agreed, and a depreciation in the US dollar. UK equity prices had underperformed counterparts in other advanced economies, with UK-focused equities having fallen a touch since the June MPC meeting.

17 UK wholesale unsecured bank funding costs had fallen back a little further since June, and were around their levels at the beginning of March. The Bank's Term Funding scheme with additional incentives for Small and Medium-sized Enterprises (TFSME) had, in part, been introduced to provide a cost-effective funding backstop for banks. Lending under the scheme had so far reached £20 billion and would exceed £100 billion over the coming year on the provisional plans submitted to the Bank by participating firms.

Credit conditions and monetary developments

18 Sterling money holdings by households, private non-financial corporations (PNFCs) and non-intermediate other financial corporations had increased further in June, by £16 billion. This was lower than the elevated flows seen in the previous three months, though markedly higher than the pre-Covid average over the year to February 2020.

19 Net finance raised by companies had been £11 billion in June, a touch lower than in May, but well above pre-Covid levels. This had largely reflected strong capital market issuance by investment-grade firms. Net borrowing from banks had been close to zero although, within that, relatively strong borrowing by SMEs had been offset by a material repayment of loans by large businesses, a similar pattern to May.

20 Lending under official support schemes had continued to rise significantly, albeit a little more slowly than in previous months. Based on data to 29 July, large companies now had outstanding drawings of around £17 billion under the Covid Corporate Financing Facility (CCFF). For small firms, as of 2 August, lenders had approved over £34 billion of loans under the Bounce Back Loan Scheme (BBS), which targeted companies with a turnover of less than £1 million. Firms with turnover of up to £45 million had had £13 billion of lending approved under the Coronavirus Business Interruption Loan Scheme (CBILS), and mid-tier companies with turnover of over £45 million had had over £3 billion approved under the Coronavirus Large Business Interruption Loan Scheme (CLBILS).

21 According to the latest Credit Conditions Survey, both the demand and availability of corporate credit had increased across all firm sizes in 2020 Q2, underpinned by the impact of the government-backed lending schemes. Demand from firms of all sizes was expected to decrease in Q3, while overall availability was expected to increase slightly.

22 Effective interest rates on new lending to all PNFCs had fallen sharply in May, by around 120 basis points, before retracing by around 30 basis points in June. This had reflected the large share of corporate borrowing through the government-backed schemes, which included a period over which borrowers did not pay any interest. That share had fallen in June.

23 Net borrowing by individuals had increased to £1.8 billion in June, following relatively large net repayments in April and May, though this remained well below pre-Covid flows. Within this, net consumer credit had been roughly flat on the month in June, after three months of strongly negative flows, reflecting an increase in gross lending that had been offset by a small increase in repayments. Net secured borrowing had also picked up somewhat.

24 Although weaker household demand was likely to have been the primary driver of the recent reduction in borrowing, tighter loan supply might have also played a role. Lenders responding to the 2020 Q2 Credit Conditions Survey conducted in mid-June had reported that there had been a reduction in mortgage and unsecured consumer credit availability in the period from March to May, and that this was not expected to recover in the period from June to August. Since the survey had been conducted, a small number of high loan-to-value (LTV) mortgage products had been relaunched.

25 The Committee continued to monitor the pass-through to deposit and lending rates of its recent 65 basis point reduction in Bank Rate. Interest rates quoted on household sight and fixed-term deposits had responded much as expected. Although the cut had been passed through in full to most existing tracker and Standard Variable Rate mortgages, quoted rates on most new fixed-rate products had been flat at low LTV ratios, and had increased at higher LTVs.

26 The Committee discussed the various factors affecting the price of new mortgage lending. It was likely that the reductions in Bank Rate and related reference rates had pushed down on new mortgage rates. But other factors had been pushing in the opposite direction, such that it was possible that, in the absence of the MPC's policy action, mortgage rates would have risen somewhat at all LTV ratios. Higher borrower credit risk related to Covid-19 had probably played some role. Banks' wholesale funding costs had picked up in March, following the market turbulence, which was likely to have affected the marginal pricing of mortgages, despite the availability of other sources of funding. It was possible that banks were also working to rebuild margins on mortgage lending, given some fall in competitive intensity in the mortgage market since the onset of Covid.

Demand and output

27 According to the ONS's monthly estimate, UK GDP had risen by 1.8% in May, a modest recovery following falls of 6.9% in March and 20.3% in April. The level of GDP in May had been 24% lower than in 2019 Q4. On the month, manufacturing and construction output had both risen by more than 8%, and distribution sector output had registered a 12.9% rise. By contrast, private non-distribution services output had fallen, by 1.2%.

28 Indicators of household spending in June had pointed to a further improvement in this component of demand. High-frequency payments data had continued to recover. The signals from these series had been substantiated by record increases in June in both retail sales, which had recovered to close to its level in February, and the broader Visa Consumer Spending Index. The latter had shown improvements across most categories of expenditure, and record growth in online spending. These data pointed to a further sharp rise in distribution sector output on the month in June.

29 Turning to other components of aggregate expenditure, the prospects for business investment also appeared to have improved over the course of 2020 Q2, although the reported decline had remained large. Respondents to the July Decision Maker Panel had indicated a decline in investment of 33%, lower than the 43% drop predicted in May. The latest number had been broadly corroborated by related data on construction output, the production of information and communications technology (ICT) and other equipment, and vehicle registrations. There had been little evidence on developments in net trade during the quarter, although trade flows appeared to have been less weak than had been expected three months earlier.

30 Taking the expected rise in distribution sector output in June together with expected further increases in manufacturing and construction output – as more firms had re-opened during the month – Bank staff expected a rise in GDP of around 9% on the month. This would correspond to a quarterly growth rate in 2020 Q2 of -21%, leaving Q2 GDP around 23% below its 2019 Q4 level.

31 Turning to 2020 Q3, there had been a substantial easing in the lockdown, such that nearly all normal spending opportunities were now open to households, albeit to varying degrees. Payments data had suggested that July had seen a marked rise in spending in pubs and restaurants, and passenger flights from the UK's main airports had trebled, although they were still only around a third of their level in February. Indicators suggested that household consumption in July had been less than 10% below its level at the start of the year, having been around 20% below on average in Q2. Social consumer spending had risen but remained below February levels. Consumers' appetite for such activities remained uncertain and might prove especially sensitive to infection rates.

32 Household spending on durable goods had recovered sharply since the April trough in activity, returning to around pre-crisis levels by the end of June, and the most recent payments data had shown a levelling off. To the extent that the prior strength had reflected pent-up demand, future growth might be expected to moderate. That said, some households continued to hold substantial unplanned savings, amassed during the lockdown, a portion of which might be run down. New car registrations had recovered sharply. And durables spending might receive further support from the housing market: although mortgage approvals and property transactions had recovered only partially from their low-points, more timely indicators, such as Zoopla data on listings added and properties sold, had recovered to pre-crisis levels.

33 Measures announced in the Chancellor's *Summer Economic Update* – in particular, the temporary cut in Stamp Duty Land Tax for homebuyers in England and Northern Ireland, and the Green Homes Grant – were likely to add further impetus to housing activity and household spending. More generally, the Chancellor's update had contained a significant further fiscal stimulus. The Plan for Jobs could provide up to £30 billion of support, in addition to which £33 billion had been made available for public spending around the middle of 2020, largely for health services.

34 Despite the recent recovery in activity from the easing of lockdown restrictions, many of the Agents' contacts had expressed concern about the demand outlook. There was a common fear of a large rise in unemployment, and apprehension about the possibility of a resurgence in Covid-19 cases, which might harm consumer confidence and lead to the re-imposition of restrictions on some activities. In addition, some contacts were concerned about uncertainties regarding the UK's new trading relations with the European Union and some other countries from January 2021, and worried about possible disruption around their introduction.

Supply, costs and prices

35 The interpretation of recent labour market data had been complicated by a number of issues, including uncertainties surrounding the classification of people across the categories of actively employed, furloughed, unemployed and inactive. Data collection via the Labour Force Survey (LFS) had also become more problematic since the onset of the crisis, and sample sizes had fallen.

36 According to the LFS, the unemployment rate in the three months to May had been 3.9%, 0.1 percentage points lower than in the previous non-overlapping three-month period. Alongside the 17,000 fall in

unemployment over the period, employment was estimated to have fallen by 126,000, while those classified as economically inactive – not in work and not actively seeking or available for work – had risen by a record 214,000. This very large increase in inactivity was likely to have reflected in part individuals' inability to be active in the jobs market during the lockdown; if so, with the easing of the lockdown, some of these people might report that they were actively seeking employment and available to work, and therefore be classified as unemployed in future surveys.

37 The fall in LFS employment had been lower than might have been expected in light of other data. The fall had been more than accounted for by a record 178,000 fall in self-employment; by contrast, the number of employees had been estimated to have risen by 97,000. The latter figure had seemed at odds with employee payroll data from HMRC, which had shown a drop of 575,000 between March and May, and a further 74,000 fall in June.

38 There were also puzzles in the unemployment data. The latest wave of LFS respondents had reported an unemployment rate of 2.2%, whereas no previous wave going back to 1995 had ever reported a rate below 3%. This unusually low outturn might have been indicative of sampling problems generated by the lockdown, which had prevented the usual practice of face-to-face interviews with new-wave respondents. It might also reflect low participation rates during the lockdown. The claimant count had risen by 1.4 million between March and June, taking the claimant count rate up from 3.5% to 7.3%, although changes in eligibility for unemployment-related benefits in response to the Covid-19 crisis meant that the rise in this figure could not be wholly attributed to increased joblessness.

39 The total number of jobs furloughed at any point under the Coronavirus Job Retention Scheme (CJRS) had been 9.6 million. However, with some staff being rotated on and off the scheme, and some people likely to have been furloughed under more than one job, the total number of employees covered was lower. On the basis of a range of survey indicators, and drawing on intelligence from the Bank's Agents, Bank staff had estimated that around a third of private sector employees – or around 7.5 million workers – had been covered by the scheme at its peak. As the lockdown had been eased, workers had been gradually returning from furlough, and the ONS's Business Impact of Coronavirus Survey had reported that around 16% – or 3.5 million workers – had still been on furlough in July.

40 As furloughed staff had continued to be included in the LFS employment figures, the decline in labour use was more apparent in the data for total hours worked. LFS data had shown a fall of around 16% in the three months to May, compared with the three months to February, although the ONS had noted that the standard imputation methodology might have understated the decline by around five percentage points. Hours worked by the self-employed had also fallen steeply.

41 The outlook for unemployment would depend both on the extent of the recovery in aggregate demand and on the degree of any structural adjustment in the demand for employees, both across sectors and within individual firms. Some sectors – most notably consumer-facing services – were likely to have to grapple with a persistent hit to demand. In addition to this, some of the Agents' contacts had reported that the experience of furloughing workers had highlighted potential productivity improvements from utilising fewer employees. A

degree of job rationalisation therefore seemed likely. At the same time, some firms reported that they were reluctant to restructure, cognisant of the potential reputational hit from announcing redundancies, having recently made use of government schemes. The flow of online job vacancies had picked up a little in July, but the stock of vacancies remained at about half of its February level. At the same time, the number of redundancy notifications had risen in April, May and June. Although these might not fully translate into job losses, it seemed highly likely that unemployment would rise significantly by the end of the year.

42 Total average weekly earnings (AWE) and HMRC median pay data had reported annual growth of -0.3% in the three months to May and June respectively. A large number of employees had seen their incomes reduced. These included those entering the CJRS, which paid furloughed employees 80% of their salary up to a maximum of £2,500 per month. That would have had a negative direct effect on the AWE data, despite around 40% of employees having received top-ups from their employers. The drag, which Bank staff estimated to be of the order of 2½% on private sector AWE at the peak in 2020 Q2, would unwind as the CJRS ran down. Reduced demand was also likely to have had a negative impact on pay growth for those employees not furloughed. Agency intelligence suggested that pay for some of those still actively employed had weakened, with bonuses having been cut and some regular pay awards having been deferred or cancelled. Some employees had taken temporary pay cuts, often in conjunction with a reduction in hours worked.

43 The existence of the furlough scheme had complicated the assessment of productivity and unit costs. In the raw data, many workers had been receiving income but doing no work, such that productivity as measured by output per worker would be very weak and unit wage costs using AWE extremely high. Bank staff had re-estimated these numbers excluding furloughed staff. On the adjusted measures, both pay and productivity were estimated to have fallen in 2020 Q2. With the fall in productivity dominating, unit wage costs were likely to have risen substantially, although this would reverse partially in Q3.

44 Annual CPI inflation had risen to 0.6% in June, from 0.5% in May. Annual core inflation had also increased, to 1.4% from 1.2%. Since the May *Monetary Policy Report*, CPI inflation had been slightly higher than expected, largely reflecting upside news in energy prices. Bank staff expected the inflation rate in July to rise further, to 0.7%, before falling sharply, and potentially turning negative, in August. This abrupt shift would be driven by two measures announced in the Chancellor's update: the cut in the rate of VAT on hospitality, holiday accommodation and attractions from 20% to 5%; and the introduction of the Eat Out to Help Out (EOHO) scheme, which would provide discounts during August. The precise impact of these measures – in particular, the degree and timing of pass-through of the VAT cut – was difficult to judge, but the drag on inflation in August was likely to be sizable. Although the EOHO effect would be confined to August, the VAT cut was likely to bear down on inflation until January 2021.

45 There had been little change in households' short and longer-term inflation expectations. Businesses' inflation expectations had softened, possibly reflecting concerns about future demand. According to the Deloitte survey, CFOs' inflation expectations two years ahead had fallen in 2020 Q2, with a pronounced rise in those expecting inflation between 0.0% and 1.5% and a corresponding fall in those expecting higher inflation rates. In the distribution sector, inflation expectations had remained subdued, according to the CBI.

The immediate policy decision

46 The MPC sets monetary policy to meet the 2% inflation target, and in a way that helps to sustain growth and employment. In that context, its challenge at present was to respond to the economic and financial impact of the Covid-19 pandemic.

47 The Committee's projections for activity and inflation were set out in the accompanying August *Monetary Policy Report*. The outlook for the UK and global economies remained unusually uncertain. It would depend critically on the evolution of the pandemic, measures taken to protect public health, and how governments, households and businesses responded to these factors. The MPC's projections assumed that the direct impact of Covid-19 on the economy dissipated gradually over the forecast period. Given the inherent uncertainties regarding the evolution of the pandemic, the MPC's medium-term projections were a less informative guide than usual.

48 The MPC's central projections continued to be conditioned on the assumption that there was an immediate but orderly move to a comprehensive free trade agreement with the European Union on 1 January 2021.

49 The Committee reviewed recent developments.

50 Global activity had strengthened over recent months. For the second quarter of 2020 as a whole, GDP had been around 15% below, around 10% below and a little above its 2019 Q4 levels in the euro area, United States and China respectively. These outturns were significantly stronger than had been expected in the illustrative scenario in the May *Report*. Covid-19 had continued to spread rapidly within a number of emerging market economies, however, and there had been a renewed rise in cases in many advanced economies.

51 In the central projections set out in the August *Report*, global GDP continued to recover. The profile of the recoveries in spending across countries varied, reflecting differences in public health and associated actions to control the spread of Covid-19, as well as the magnitude of policy responses. For example, the recovery in the United States was assumed to be a little slower as a result of the increase in Covid cases in recent weeks.

52 Global risk sentiment had been fairly stable, although volatility had remained elevated. Government bond yields in major advanced economies had declined further, while short-rate expectations had fallen to a somewhat greater degree in the United Kingdom than in other countries. The MPC was not expected to adjust monetary policy at this meeting.

53 As of 4 August, the total stock of the Asset Purchase Facility had reached £662 billion, an increase of £217 billion as part of the programmes of asset purchases announced on 19 March and 18 June. Within that increase, £210 billion of UK government bonds, and £7.9 billion of sterling non-financial investment-grade corporate bonds, had been purchased since March.

54 Since the start of the year, the Government had increased spending materially to support the economy. In its *Summer Economic Update* in July, the Government had announced a Job Retention Bonus of £1,000 for

each previously furloughed employee still employed by 31 January 2021, alongside other schemes to support jobs. It had also announced a temporary cut in VAT for hospitality and accommodation, and a temporary increase in the Stamp Duty threshold. In addition, government spending had been increased. Taken together, these measures boosted activity substantially over the forecast period.

55 UK GDP was expected to have been over 20% lower in 2020 Q2 than in 2019 Q4. But higher-frequency indicators implied that spending had recovered significantly since the trough in activity in April, and to a greater degree than had been anticipated in the May illustrative scenario. Payments data suggested that household consumption in July had been less than 10% below its level at the start of the year. Social consumer spending had risen but remained below February levels, while spending on durable goods had levelled off at around pre-crisis levels. Housing market activity appeared to have returned to close to normal levels, despite signs of a tightening in credit supply for some households. There was less evidence available on business spending, but surveys suggested that business investment was likely to have fallen markedly in Q2 and investment intentions remained very weak.

56 Employment appeared to have fallen since the Covid-19 outbreak, although this had been very significantly mitigated by the extensive take-up of support from temporary government schemes. HMRC payroll data had shown a drop of around 650,000 between March and June, while around 7½ million workers were estimated to have been covered by the Coronavirus Job Retention Scheme (CJRS) at its peak. Surveys indicated that around 4 million workers had already returned to work from furlough, but considerable uncertainty remained about the prospects for employment after the government support schemes were unwound. In the near term, the unemployment rate was projected to rise materially, to around 7½% by the end of the year, consistent with a material degree of spare capacity.

57 In the MPC's central projection, GDP continued to recover beyond the near term, as social distancing eased and consumer spending picked up further. Business investment also recovered, but somewhat more slowly. Unemployment declined gradually from the beginning of 2021 onwards. Activity was supported by the substantial fiscal and monetary policy actions in place. Nonetheless, the recovery in demand took time as health concerns dragged on activity. GDP was not projected to exceed its level in 2019 Q4 until the end of 2021, reflecting persistently weaker supply capacity. Given the scale of the movements in output, as well as the inherent uncertainty over the factors determining the outlook, the evolution of the balance between demand and supply was hard to assess. The MPC's central projection implied that a margin of spare capacity was likely to remain until the end of next year.

58 Twelve-month CPI inflation had increased to 0.6% in June from 0.5% in May, while core CPI inflation had also risen, to 1.4% from 1.2%. CPI inflation was expected to fall further below the 2% target and average around ¼% in the latter part of the year, largely reflecting the direct and indirect effects of Covid-19. These included the impact of energy prices and the temporary reduction in VAT for hospitality, holiday accommodation and attractions. Bank staff expected the inflation rate to rise slightly further in July, before falling sharply, and potentially turning negative temporarily, in August, reflecting the impact of the VAT cut and the Eat Out to Help Out (EOHO) scheme. Although the EOHO effect would be confined to August, the VAT cut was likely to bear down on CPI inflation until January 2021.

59 As the effects of temporary factors unwound, inflation was expected to rise, supported by a gradual strengthening of domestic price pressures as spare capacity diminished. In the MPC's central projection, conditioned on prevailing market yields, CPI inflation was expected to be around 2% in two years' time.

60 The MPC was continuing to monitor closely developments in indicators of inflation expectations, including those of households, businesses and financial markets. Overall, the Committee judged that inflation expectations remained well anchored and consistent with inflation close to the 2% target.

61 The Committee turned to its immediate policy decision.

62 Relative to the illustrative scenario in the *May Report*, activity in the UK and global economies had been less weak than expected over recent months. Domestically, consumer spending had picked up significantly, due in part to the earlier than expected easing of restrictions on economic activity. Adverse labour market outcomes, and the resulting reduction in household incomes, had also been mitigated materially by government support schemes. Although these developments suggested a less weak starting point for the Committee's latest projections, it was unclear how informative they were about how the economy would perform further out.

63 Overall, the risks to the outlook for GDP were judged to be skewed to the downside, albeit that different members placed different weights on the nature and the scale of these risks.

64 Conditions of persistent uncertainty could create strong incentives for households and companies to defer major spending decisions and focus on balance sheet resilience. A greater number of corporate investment projects might not be profitable in the event that health risks associated with the pandemic persisted. Some households might choose to save more than anticipated in response to the same risks.

65 The outlook for social spending would continue to be sensitive to people's perceptions of health risks as well as any formal restrictions on those activities. There had been a slight uptick in new UK Covid-19 cases in recent weeks and some renewed local lockdown measures. The pattern of spending in the United Kingdom was particularly susceptible to such perceived health risks given that social consumption formed a bigger part of household spending than in most other advanced economies. Spending less on one category of consumption did not necessarily mean a reduction in the total, however; over time, those aggregate decisions should be more closely related to expectations of, and uncertainty about, future income.

66 Demand-driven structural change brought on by the pandemic could also have longer lasting effects on the supply capacity of the economy, and to a greater degree than had been incorporated in the *August Report*. Increases in unemployment could prove to be more persistent than assumed currently. Given that recent shifts in the pattern of consumption spending had occurred much more quickly than in previous periods of structural change, employment in the worst-affected sectors could fall to a greater extent than envisaged. That could lead to a larger increase in aggregate unemployment if those workers were not re-employed quickly in less-affected sectors. The implications for productivity of a prolonged shift away from labour-intensive sectors of the economy were harder to assess. In theory, productivity could increase in this scenario, although this was likely to depend heavily on companies investing in more capital-intensive activities.

67 The Committee would continue to monitor the situation closely and stood ready to adjust monetary policy accordingly to meet its remit. The MPC would keep under review the range of actions that could be taken to deliver its objectives. The Committee did not intend to tighten monetary policy until there was clear evidence that significant progress was being made in eliminating spare capacity and achieving the 2% inflation target sustainably.

68 At this meeting, all members judged that the existing stance of monetary policy was appropriate.

69 The Chair invited the Committee to vote on the propositions that:

Bank Rate should be maintained at 0.1%;

The Bank of England should continue with its existing programmes of UK government bond and sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, maintaining the target for the total stock of these purchases at £745 billion.

The Committee voted unanimously in favour of both propositions.

70 As set out in the Market Notice accompanying these minutes, the Committee continued to expect the UK government bond asset purchase programme to be completed, and the total stock of purchases to reach £745 billion, around the turn of the year. With liquidity conditions having stabilised, purchases could now be conducted at a slower pace than during the earlier period of market dysfunction. Should market conditions worsen materially again, however, the Bank stood ready to increase the pace of purchases to ensure the effective transmission of monetary policy.

71 Consistent with the Committee's previous guidance, and as described in the accompanying Market Notice, the Committee agreed to reinvest £7.0 billion of cash flows associated with the redemption of the September 2020 gilt held by the Asset Purchase Facility.

72 The following members of the Committee were present:

Andrew Bailey, Chair
Ben Broadbent
Jon Cunliffe
Andrew Haldane
Jonathan Haskel
Dave Ramsden
Michael Saunders
Silvana Tenreyro
Gertjan Vlieghe

Clare Lombardelli was present as the Treasury representative.

As permitted under the Bank of England Act 1998, as amended by the Bank of England and Financial Services Act 2016, Anne Glover was present on 28 July, as an observer for the purpose of exercising oversight functions in her role as a member of the Bank's Court of Directors.