

THE BANK OF ENGLAND MPC MINUTES DISSECTION

	December 4, 2008	November 6, 2008	October 8, 2008
THE TD TAKE	The first tinge of positive thinking in several months. The MPC refers to diminished downside risks to output growth, increasing consumer purchasing power, clarifies that rate cuts are ineffective at alleviating supply constraints for credit (demand constraints though, yes). But note at this point, this is positive thinking, not fact. With rate cuts front-loaded, the BoE may ease back on the throttle. A 50bps cut in January is likely (with a small risk to the downside), but the BoE is unlikely to break with whatever market expectations are at the time. Given our dour economic forecasts for the UK, an eventual floor of effectively zero is likely.	New BoE projections look for a "pronounced slowdown" in spite of "substantial" stimulus. The 150bps surprise cut was seen as necessary (but not sufficient) by the MPC, so much more is on the way. And the MPC is taking the view that they need to cut more than usual to overcome the fact these cuts are less stimulative than in the past (due to banking issues). This is tempered only by the desire to see the details of fiscal stimulus and save some cuts for later as a confidence measure. Increasingly likely rates will fall below 1.00%.	The Bank of England joined in with the global coordinated central bank cuts. There is not a whiff of any upside to anything anywhere in the minutes. As such, expect more cuts from the BoE on the way, with our expectation for 150bps of cuts into the start of 2009 with the easing front-loaded.
MPC REASONING			
Balance of Risks	The timing of discretionary spending changes announced in the PBR [Government's Pre-Budget Report], and the cut in VAT, were likely to be <i>helpful in offsetting the downside risks to output growth in 2009</i>Overall, the medium-term outlook for inflation appeared to have shifted downwards since the November MPC meeting.	The biggest risks to inflation stemmed from the uncertain depth and persistence of the slowdown in demand.	Over the month, the risk of a sharper monetary contraction had risen, and hence of a more pronounced slowing in activity and employment than was needed to keep inflation at target in the medium term.
MPC Assessment	...Bank Rate was not the right policy instrument to tackle supply constraints in the credit market.....without further policy action, inflation would substantially undershoot the target in the medium term.... <i>a cut of at least 100 basis points was needed</i>a larger cut might be justified by the scale of the downside risks to inflation. <i>A number of arguments were, however, advanced against a larger cut</i> [potential impact of larger than expected cut on the currency and confidence, the pace of pace easing, the new fiscal measures]...	...strong case for an immediate reduction in Bank Rate of at least 100 basis points...The problems affecting the banking sector had probably reduced the impact of reductions in Bank Rate on activity. This <i>reinforced the need for a substantial reduction in Bank Rate</i>a very significant reduction in Bank Rate – possibly in excess of 200 basis points – might be required...some members thought there was an argument for leaving some of the required policy loosening to the months ahead to support confidence as the economy weakened....immediate reduction in Bank Rate of 1.5 percentage points to 3% was <i>necessary</i> to meet the 2% target for inflation in the medium term.	<i>All these developments</i> pointed to the need for a relaxation in monetary policy. In the current financial market turbulence, the reduction in Bank Rate that would ultimately be required to meet the inflation target was very difficult to gauge. But the evidence available now was <i>clearly sufficient</i> to justify a reduction in Bank Rate of 50 basis points this month.
Decision	100bps cut to 2.00%; 0-9-0 (Hold-Cut-Hike) Link to text	150bps cut to 3.00%; 0-9-0 (Hold-Cut-Hike) Link to text	50bps cut to 4.50%; 0-9-0 (Hold-Cut-Hike) Link to text

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REAL ACTIVITY			
Consumer	Those developments [diminished global inflation and commodity prices] should help support households' purchasing power.	A squeeze on real income growth and the tightening in credit conditions had weakened consumer spending....households were probably trying to increase their precautionary savings...most evident in the demand for consumer services and durables.	Consumer spending growth had slowed, in part as a result of the squeeze on real incomes...
Investment	...the latest data had indicated that the flow of lending to private non-financial companies had risen a little in October. The evidence on trade credit (such as credit insurance or letters of credit) was more downbeat,	...anecdotal evidence that the supply of trade credit, and companies' working capital more generally, were being curtailed...Companies' investment intentions had fallen sharply....appeared to reflect greater concerns about the demand outlook....	Many (intl money and credit) markets had closed. In the United Kingdom, the supply of credit to households and firms had clearly tightened further as banks sought to adjust their balance sheets....further material tightening in credit conditions for households and firms over coming months.
MPC Assessment	A mapping from the surveys into GDP suggested falling output in both the fourth quarter of 2008 and the first quarter of 2009....To the extent that the weak output data reflected a stock cycle, it was possible that output growth would recover relatively quickly once the pace of de-stocking slowed. But if a more persistent weakening in demand and output was in train, then the recovery would be somewhat later.	...near-term outlook for GDP had deteriorated substantially....The central projection for GDP growth over the next two years was substantially weaker than in the August Report....continued severe contraction in the near term.	The outlook for activity in the second half of 2008 had weakened markedly. Data released over the past month indicated that the outlook for economic activity in the United Kingdom had deteriorated substantially, reflecting a sharp monetary contraction.
INFLATION			
Non-labour prices	M4 growth was very weak. Within this, the broad money balances of private non-financial companies had continued to contract sharply.	...further falls in producer input and output prices in September, and surveys suggested that the downward pressure on these prices would continue...	...commodity price pressures had eased, with oil prices down substantially from their mid-summer peak....Broad money growth had continued to slow...
Wages	Pay growth had remained subdued up to September.	...pay growth had remained subdued...	Pay growth had so far remained subdued...
Capacity	...the labour market had continued to weaken...a significant margin of spare capacity would open up over the next couple of years.	Labour market conditions had deteriorated markedly in recent months.	But inflation was then likely to drop back, as...the margin of spare capacity in the economy increased...The weakness in output growth at home was likely to open up a growing margin of spare capacity that would over time bear down on inflation.
Expectations	Many survey measures of inflation expectations for 2009 had fallen sharply since the previous MPC meeting.	Indicators of near-term inflation expectations had <i>fallen back sharply</i>even though CPI inflation had continued to rise....its [five-year breakeven rate] largest fall over a comparable period since late 1993.	Despite the further rise in CPI inflation, the evidence on inflation expectations was broadly unchanged....the risk that inflation expectations for the medium term would be dislodged had diminished in the light of the weaker outlook for economic activity.
MPC Assessment	The direct effects [of temporary reduction in VAT rate from 17.5% to 15% for 13 months] might reduce CPI inflation by around one percentage point through most of 2009, followed by a corresponding addition to inflation during 2010. Overall, the medium-term outlook for inflation appeared to have shifted downwards since the November MPC meeting.	The central projection for CPI inflation was for it to fall back sharply...in the near term...Further out, inflation fell well below the 2% target, reflecting a larger margin of spare capacity and the waning impact on import prices from the lower level of sterling...the <i>downward revision to the CPI projection was the largest since the MPC was established</i> .	The Committee judged that, during the past month, the <i>balance of risks to inflation in the medium term had shifted decisively to the downside</i> .