Bank of England

May 2022

Monetary Policy Report

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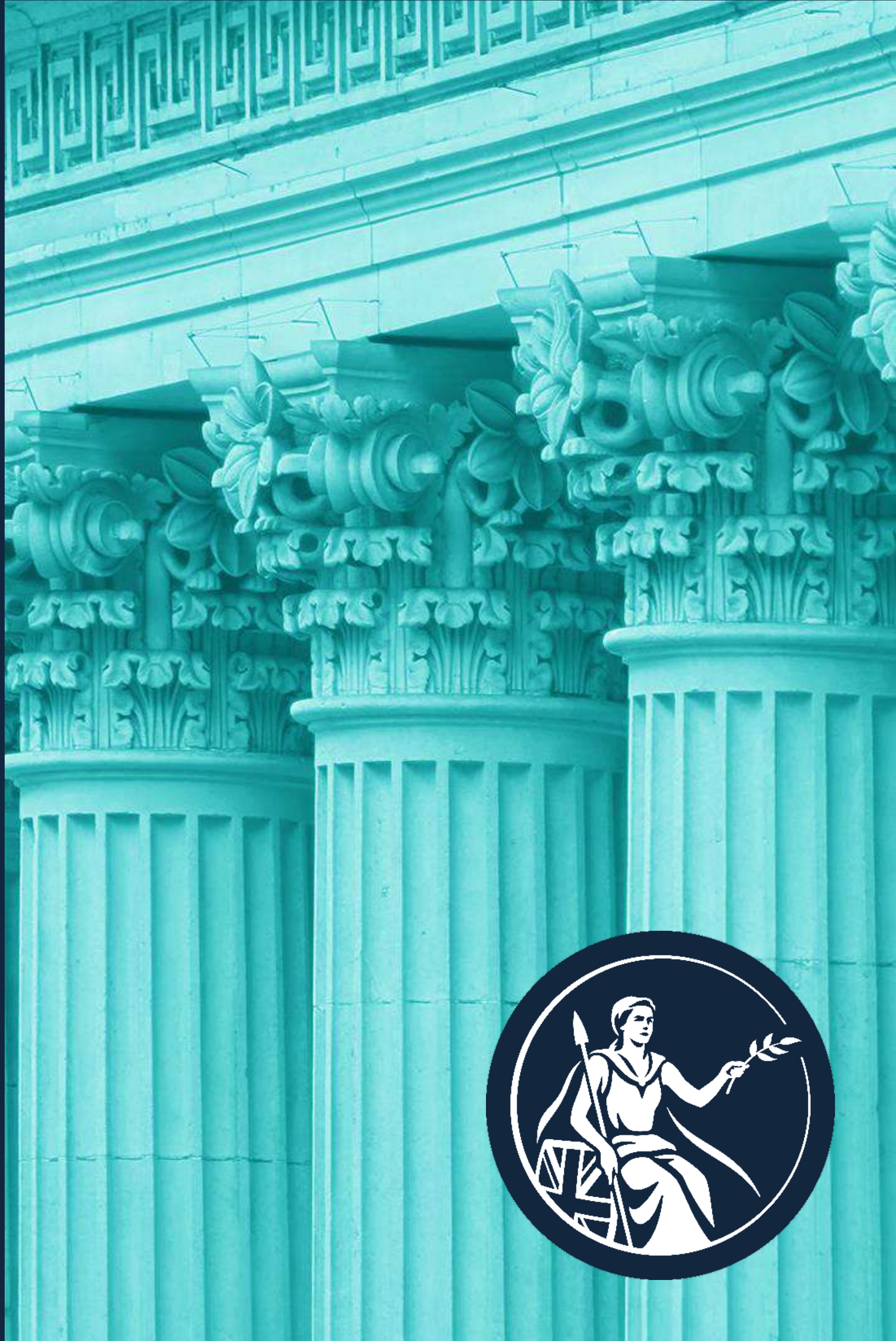
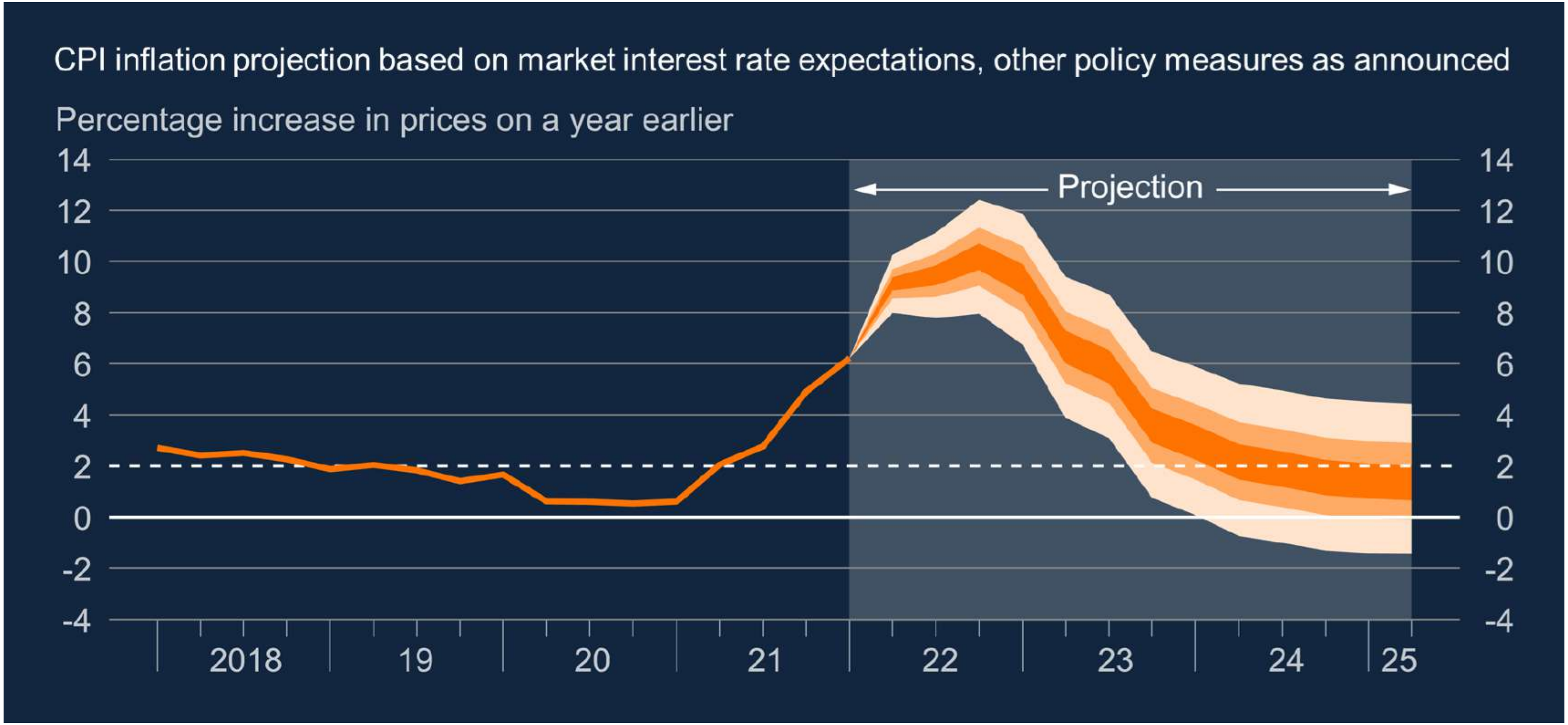


An inflation forecast with two clear phases



Story behind the MPC's central outlook for the economy

- War in Ukraine has led to further sharp rises in commodity prices and more pressure on global supply chains

Gas futures curves are materially higher than in February

- Gas prices hit historic highs in the aftermath of the invasion
- Futures curve is well above February level
- This is likely to push Ofgem's energy price cap up by another 40% in October.

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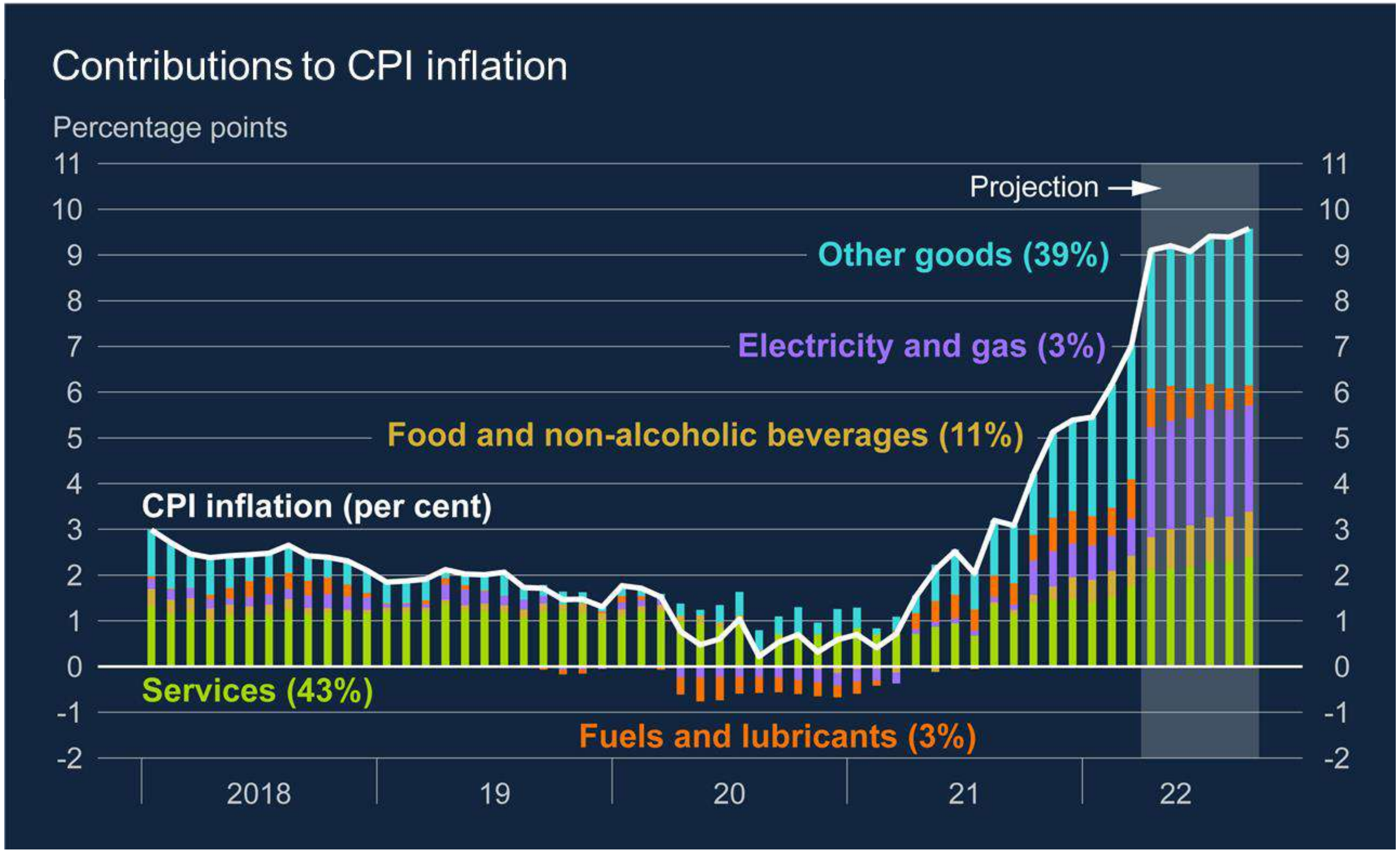
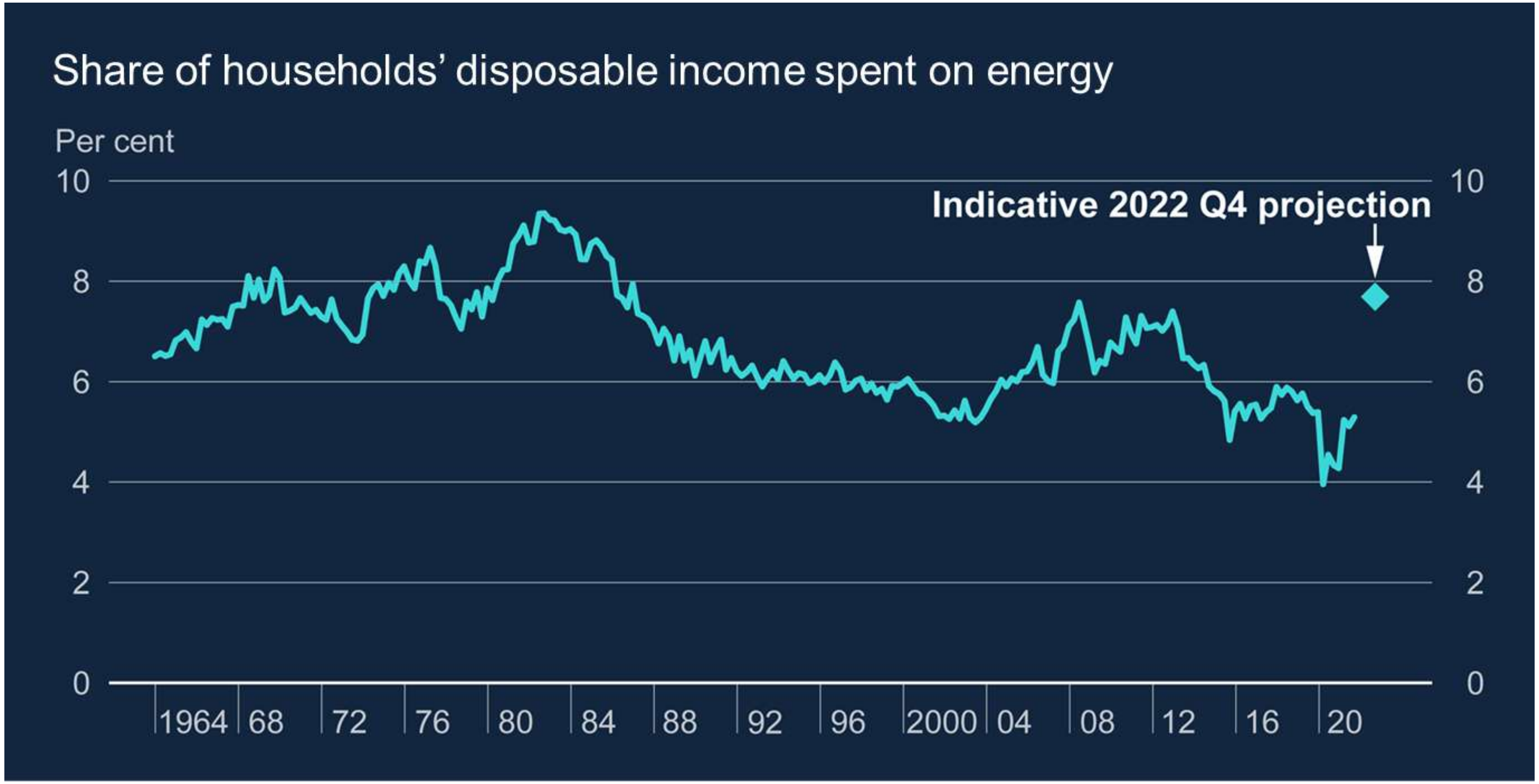
Energy and goods prices the major drivers behind the pick up in inflation



- Energy prices and supply bottlenecks drive most of the increase
- Services inflation also drifting higher

The share of income spent on energy is likely to increase this year



- Households may spend close to 8% of their disposable income on energy by Q4
- Difficult to substitute away from, so less income to spend elsewhere

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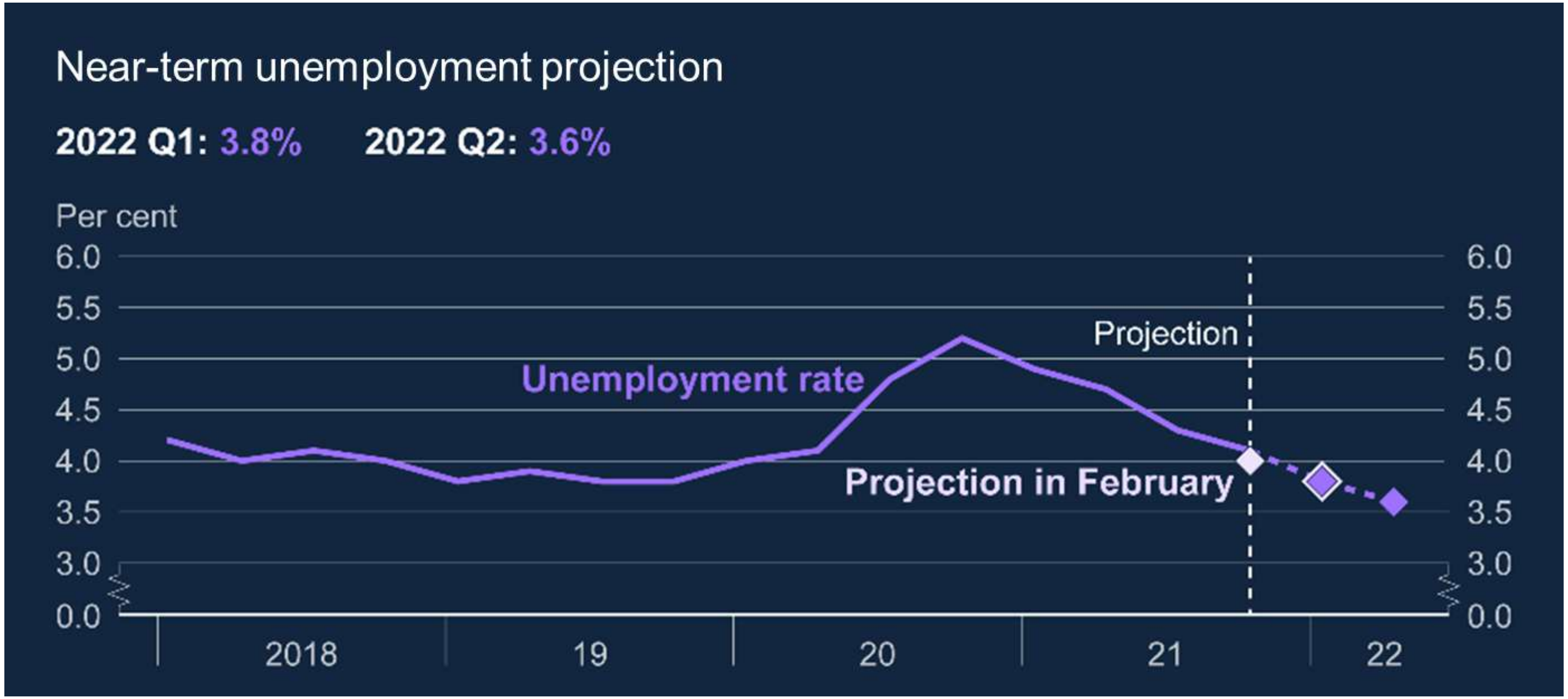
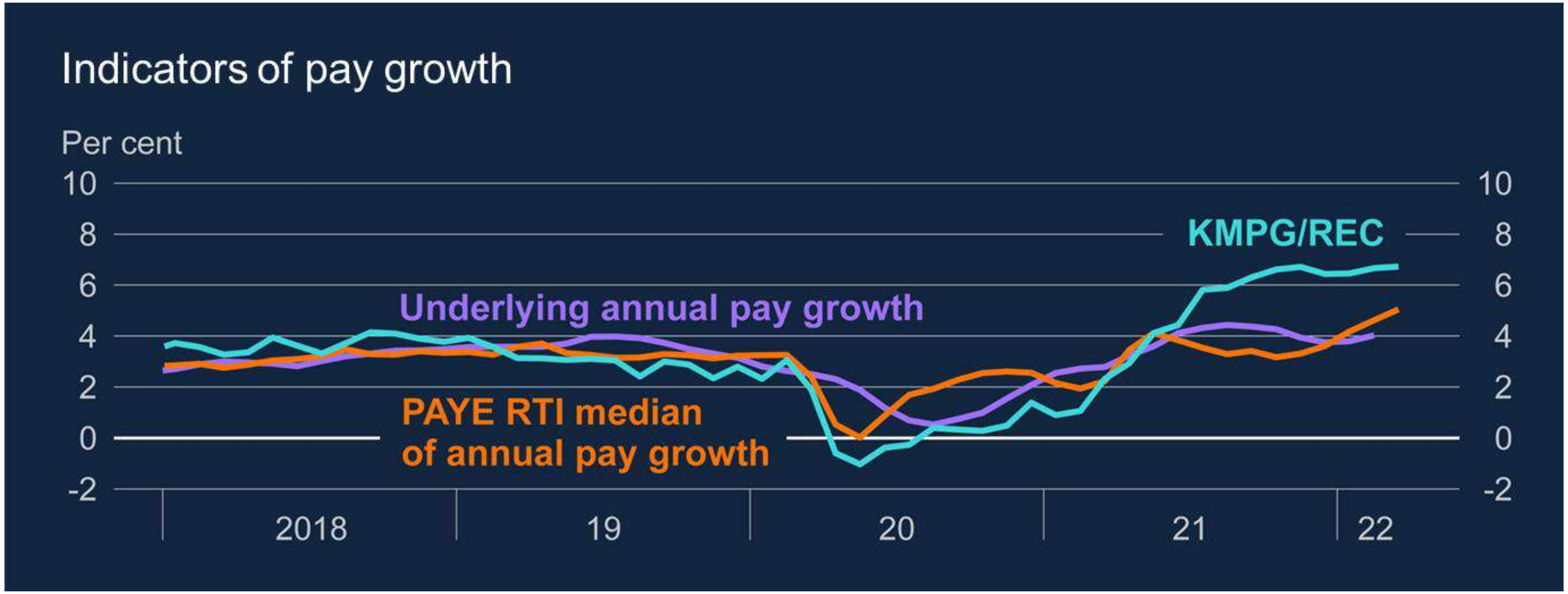
Unemployment is likely to fall for another couple of quarters



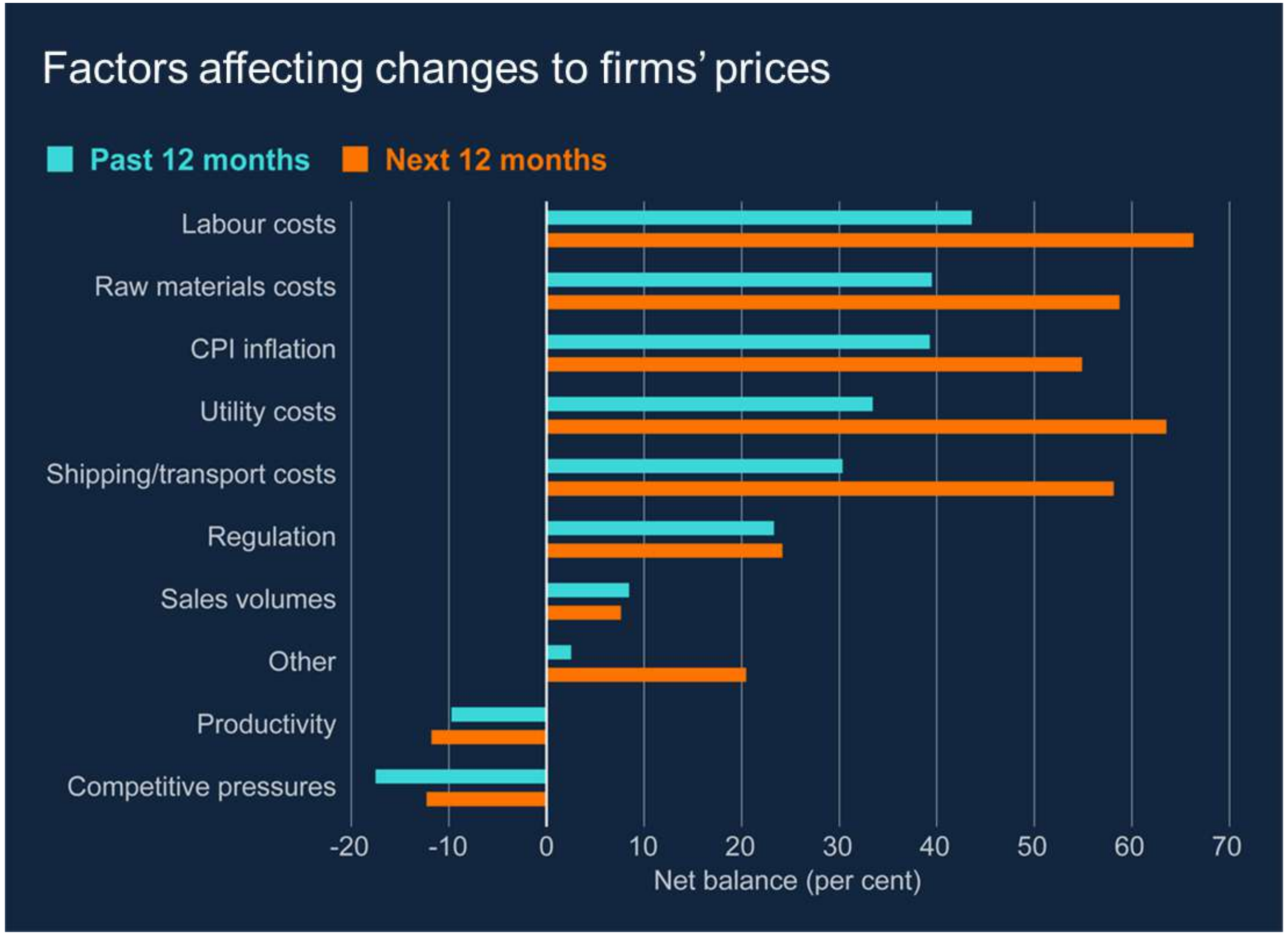
- Business sentiment continues to hold up and vacancies at record levels
- Employment intentions consistent with unemployment falling to 3.6% in Q2

Pay growth indicators if anything suggest upside risks in the near-term



- Underlying pay growth running at 4-4½%, with headline growth of 5¾% likely this year
- High frequency indicators corroborate the pickup and suggest upside risks

Business identify range of domestic and global factors pushing up prices



- Respondents to Agents' survey see the global influences on upward prices (raw materials, energy, shipping)…
- …but also identify labour costs and higher overall inflation as an issue
- Businesses across all sectors plan to raise prices by more than last year

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- But, as energy and tradables prices stabilise, inflation will fall back…

Futures curves suggest now further rise in energy prices from here

- Energy prices need to keep rising at recent rates for their contribution to inflation to stay elevated
- MPC assume they stay flat; futures curve suggests downside risks

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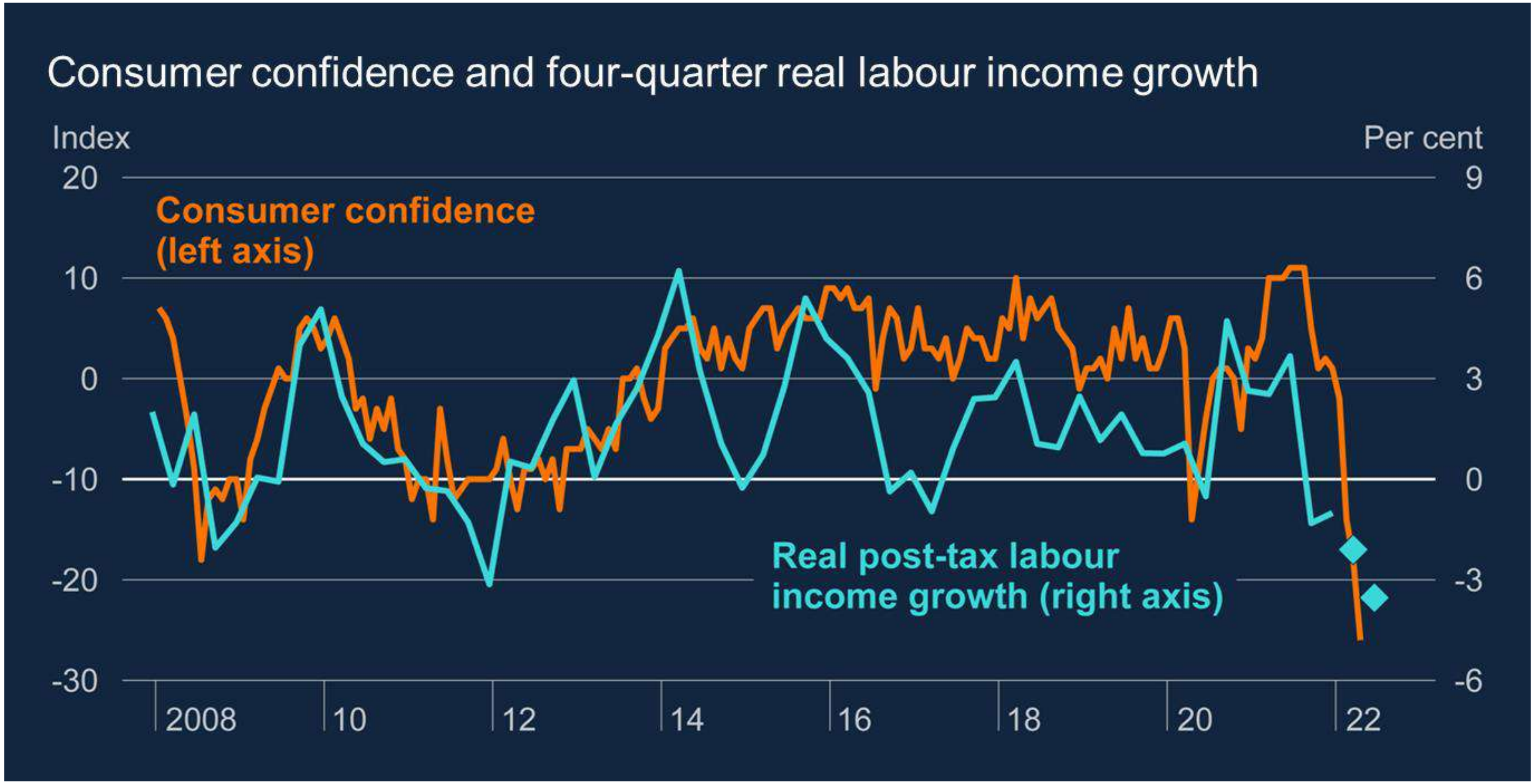
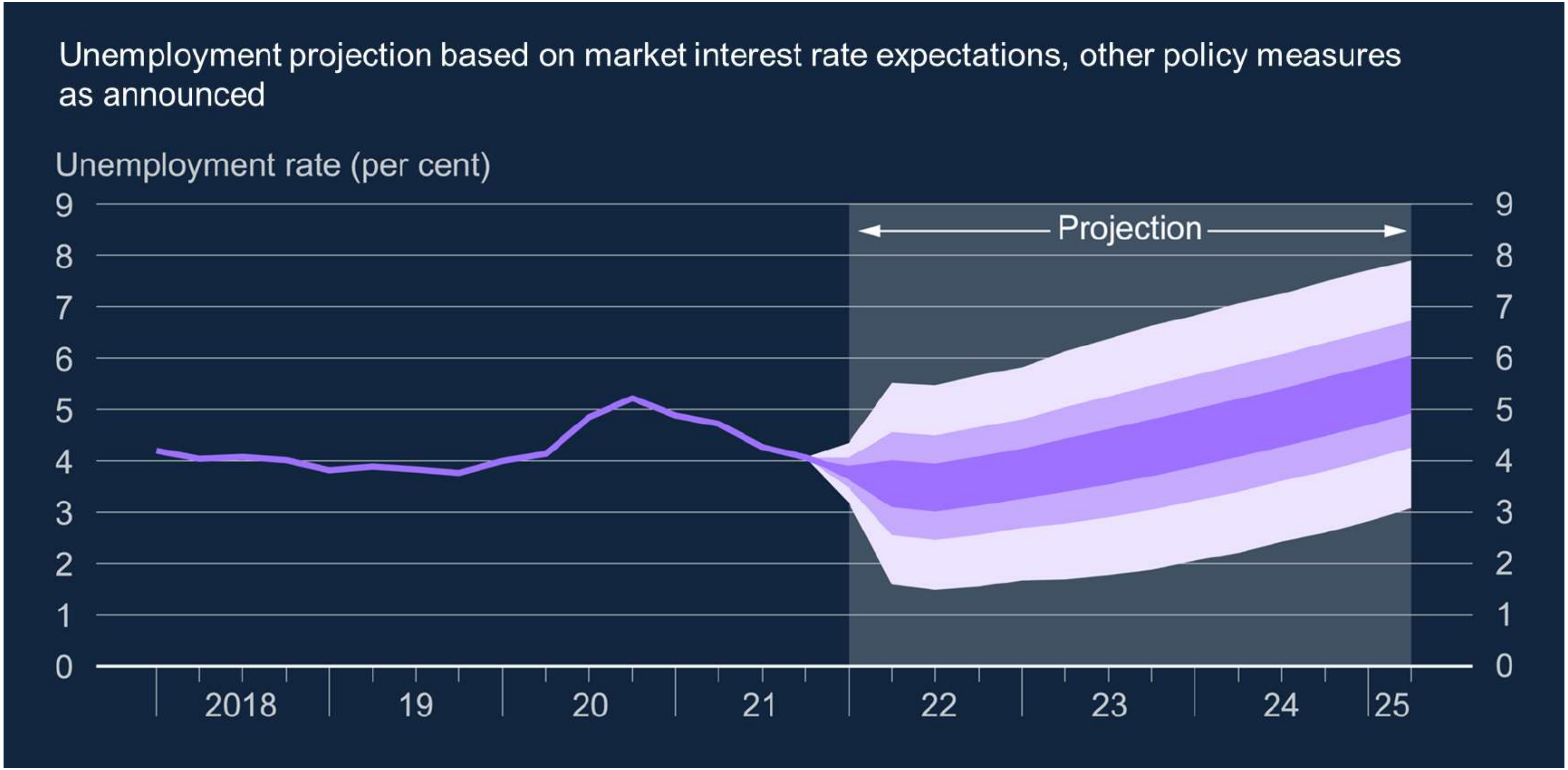
- …and will fall back further as consumers rein in spending and spare capacity opens up

As real incomes have started to be squeezed, consumer confidence has fallen



- Labour income growth (measure most visible to households) already negative in real terms
- GfK consumer confidence has fallen on all balances

Unemployment picks up towards the end of the year and rises to 5½% by the end



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- Inflation is likely to be back at the 2% target in two years' time, and maybe below it further out

The narrow path for monetary policy

- Russia’s invasion of Ukraine means the UK pays higher prices for imported energy and tradables. Monetary policy is unable to prevent this.
- Monetary policy navigating a narrow path between increased risks from elevated inflation and a tighter labour market on the one hand, and the further hit to activity from the reduction in real incomes on the other.
- MPC voted in May to increase Bank Rate by 25bps, given current labour market tightness, continuing signs of robust domestic price pressures, and risk that those pressures will persist.
- Most members judge that some degree of further tightening in policy may still be appropriate in the coming months, and see two-sided risks around this judgement. Some members judge that risks around activity and inflation over policy horizon are more evenly balanced and this guidance is not appropriate.