Bank of England

May 2023

Monetary Policy Report

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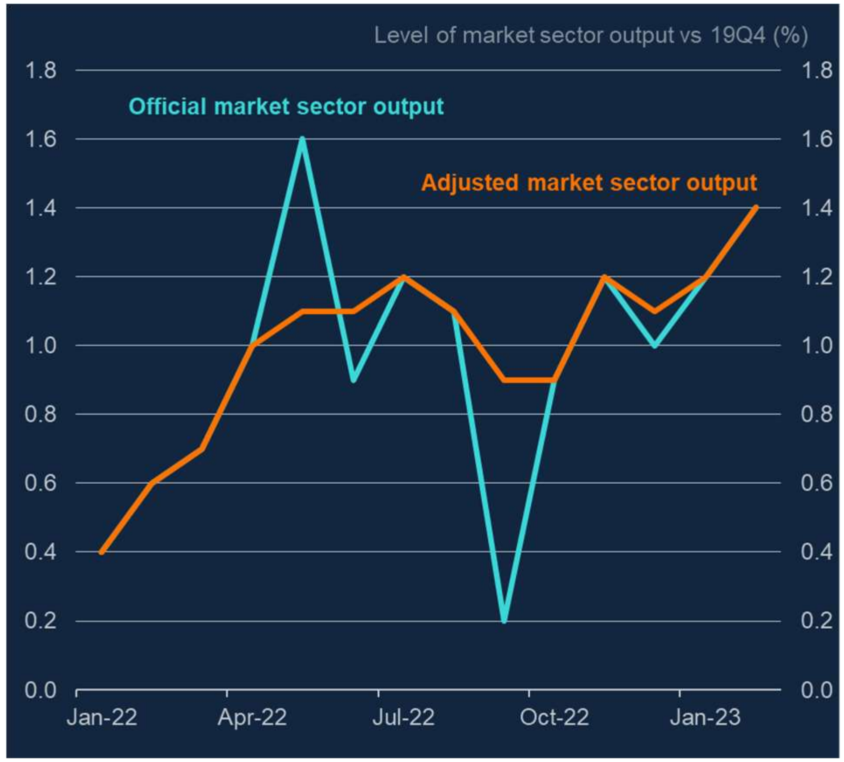
Thursday 18th May 2023

Main points

- Inflation expected to fall back to around 7% by mid-year, driven by energy effects.
- Food price inflation remains very strong.
- The demand outlook has strengthened, not least owing to lower energy prices.
- But slack in the economy is still expected to open up, leading to inflation falling below the 2% target in the medium term.
- There are large upside risks to that though if high inflation and the tight labour market lead to more-persistent domestic price and wage inflation.
- Taking account of those risks, the prospects for inflation are much closer to the 2% target.

Underlying GDP was flat in 22H2, but has picked up in early 2023



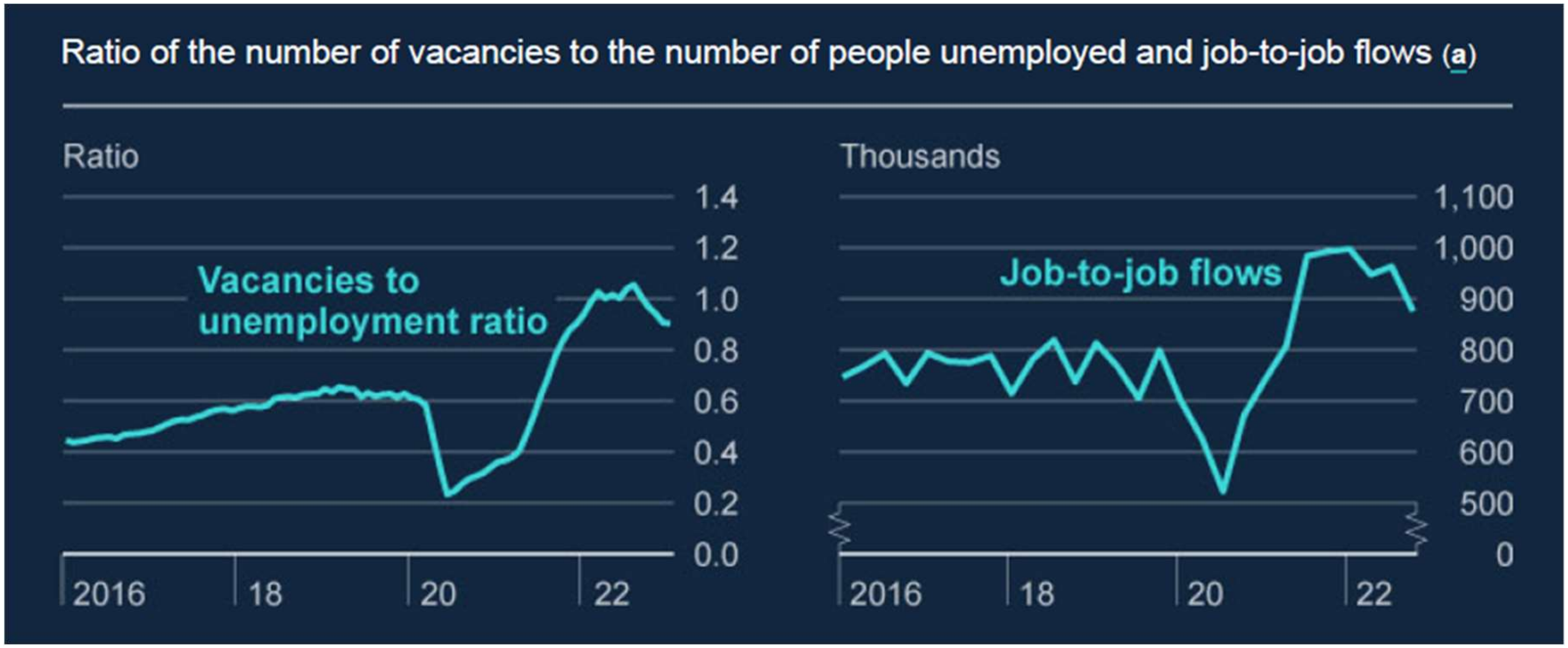
- Strikes and extra Bank Holidays are causing volatility in headline GDP
- Looking through that, signs of underlying growth running at ≈¼% per quarter

Business surveys suggest the outlook for growth has improved

- Since their trough last autumn, businesses report firmer output and orders and have become more optimistic about the future.

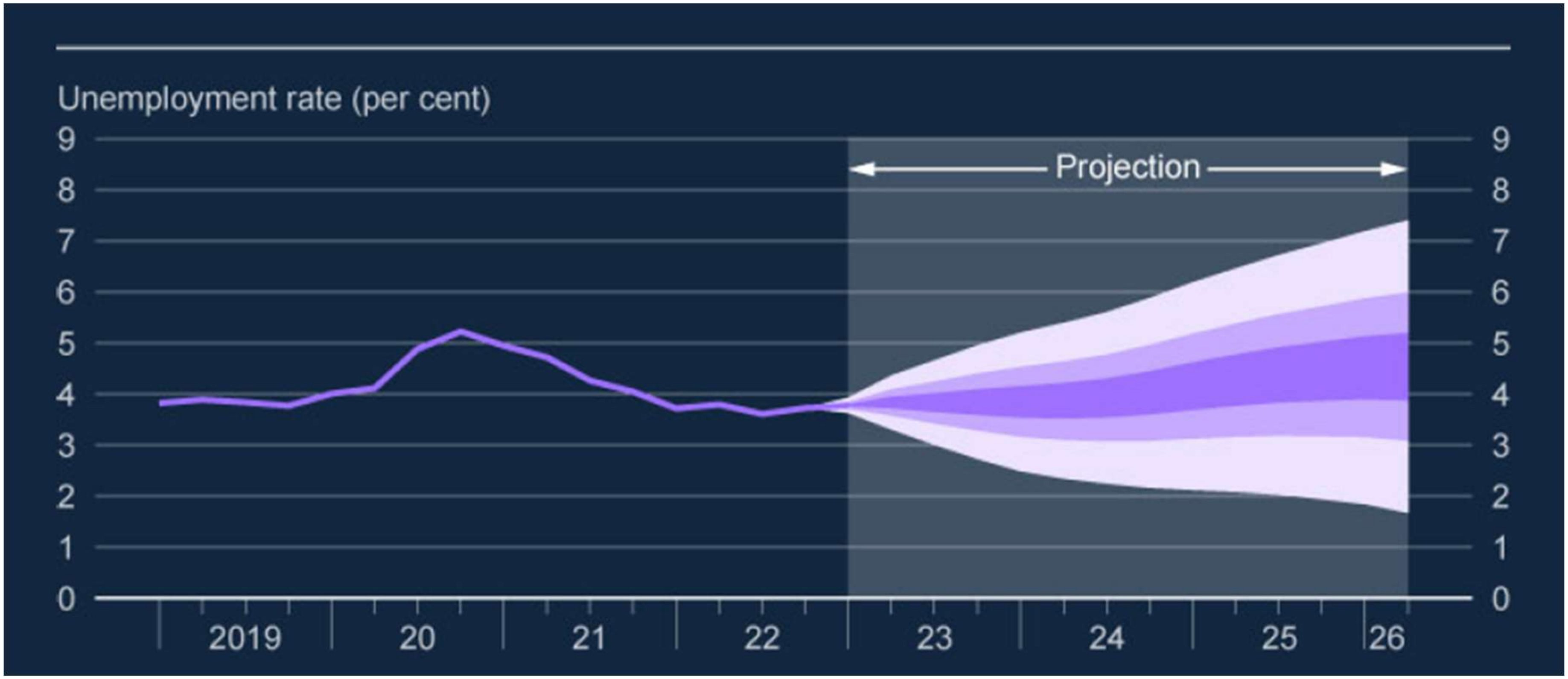
Employment growth has been positive, and employment intentions point to further growth in the near term

The labour market remains tight, but there are signs that it is loosening a little

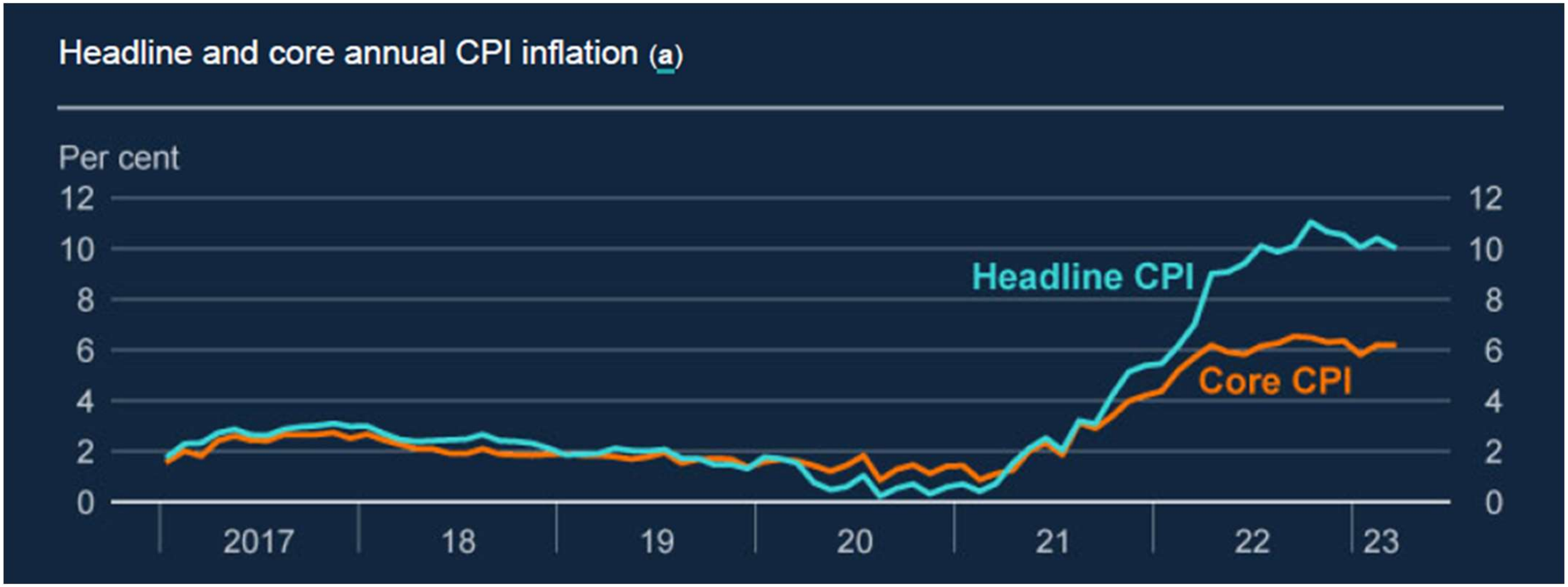


- Although employment growth has picked up a little, vacancies have fallen back and fewer people are moving jobs
- Companies report that recruitment difficulties have eased

Unemployment expected to remain broadly flat in the near-term

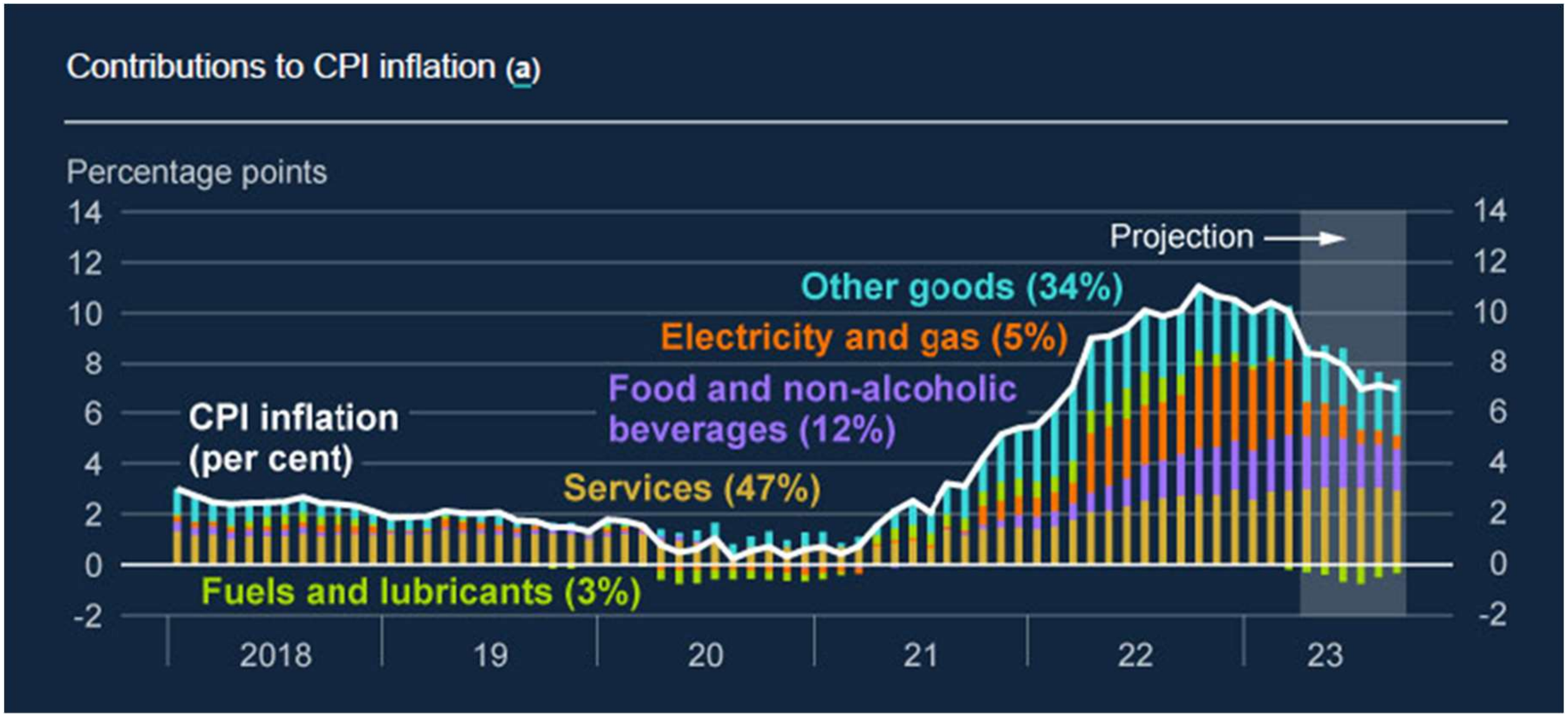


Headline and core CPI inflation remain elevated



- Core inflation, which strips out more volatile energy and food prices has been around 6% for around a year, with some second round effects present.

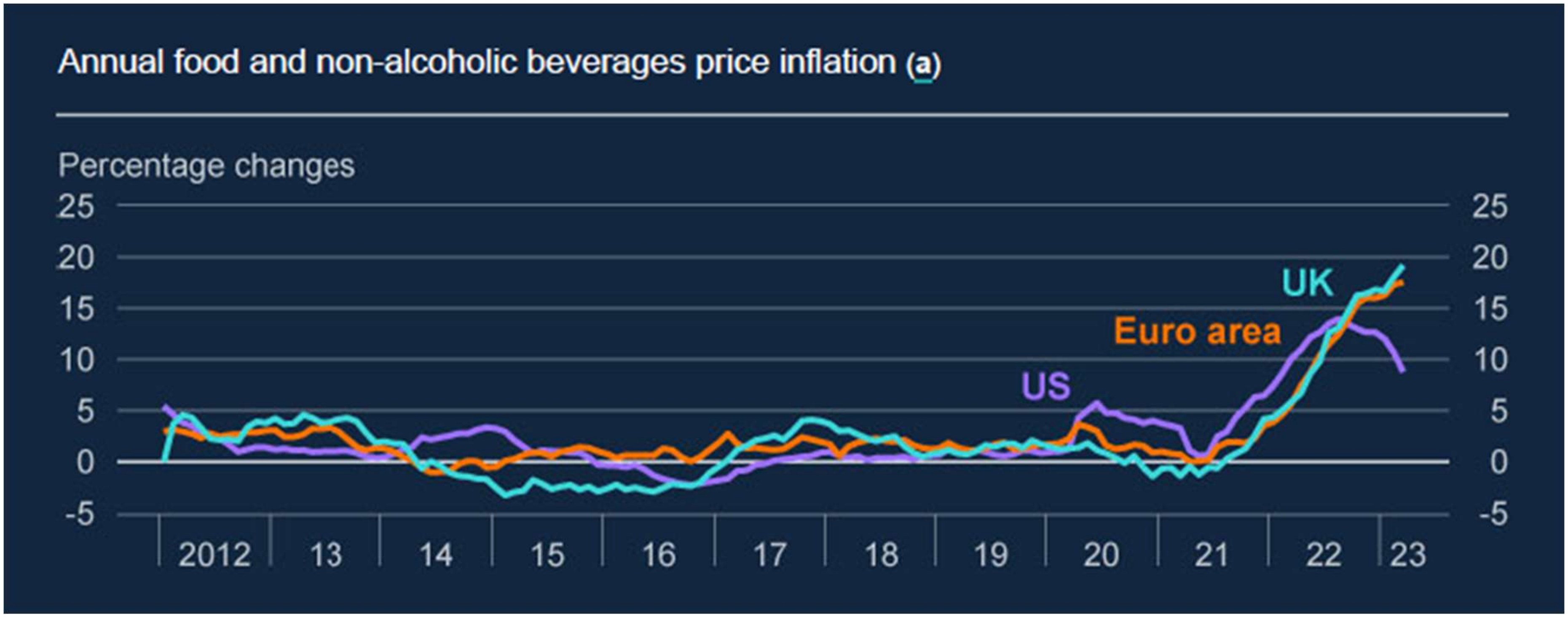
CPI inflation expected to fall to around 7% by mid-2023



- We expect CPI inflation to fall to ≈8½% in April as the Energy Price Guarantee (EPG) is maintained at £2500 and last year’s energy price increases drop out.

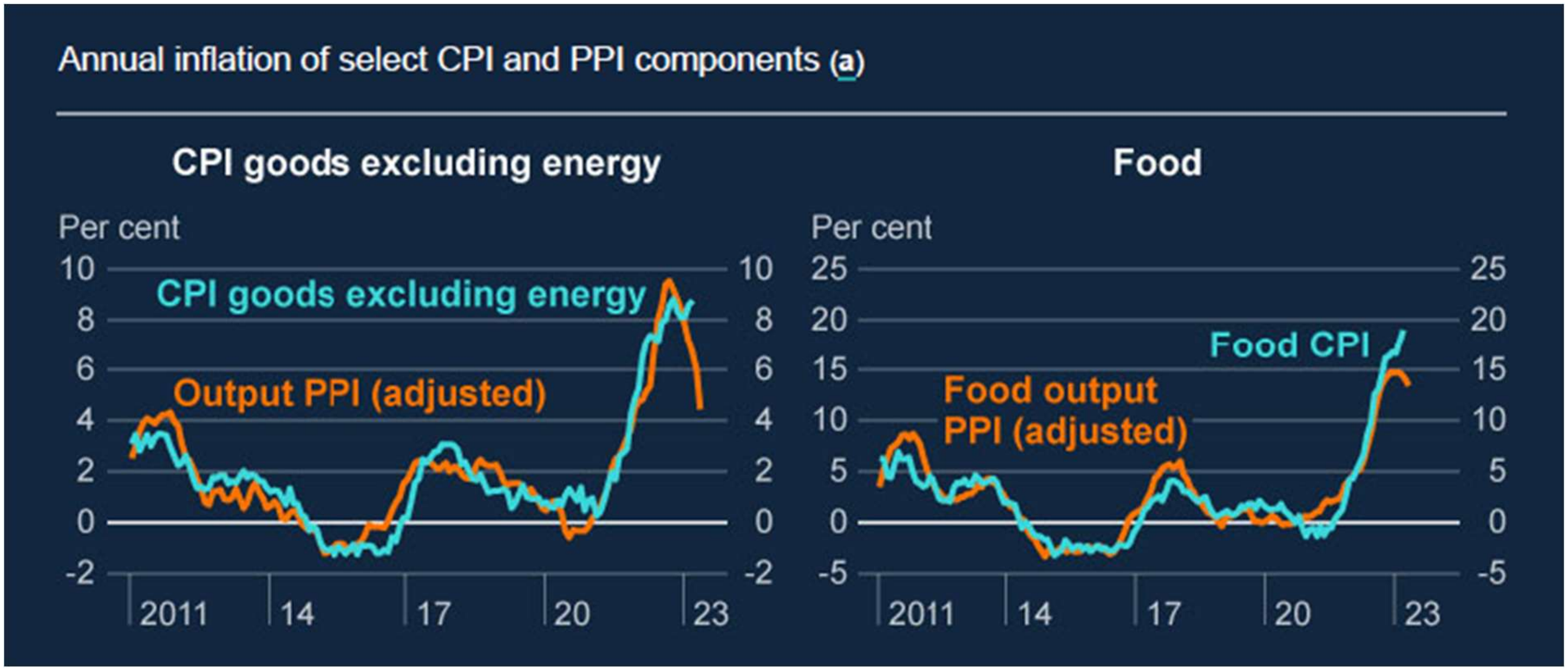
Wholesale gas prices have declined substantially

Food price inflation is similar in Europe and UK



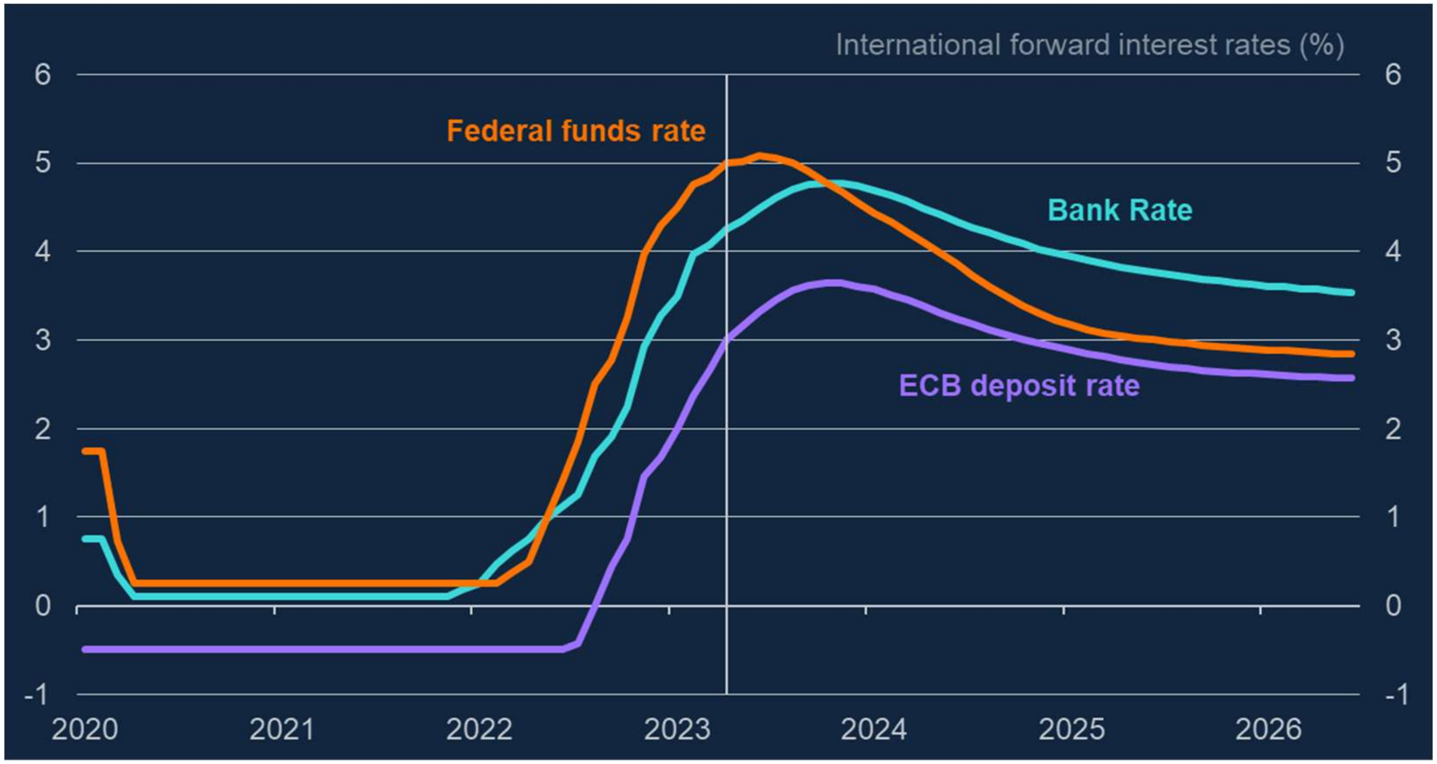
- Food price inflation of 18-19% in both the euro area and the UK suggests that common increases in production costs are the main cause.

Producer price inflation is falling, but less so in the food sector



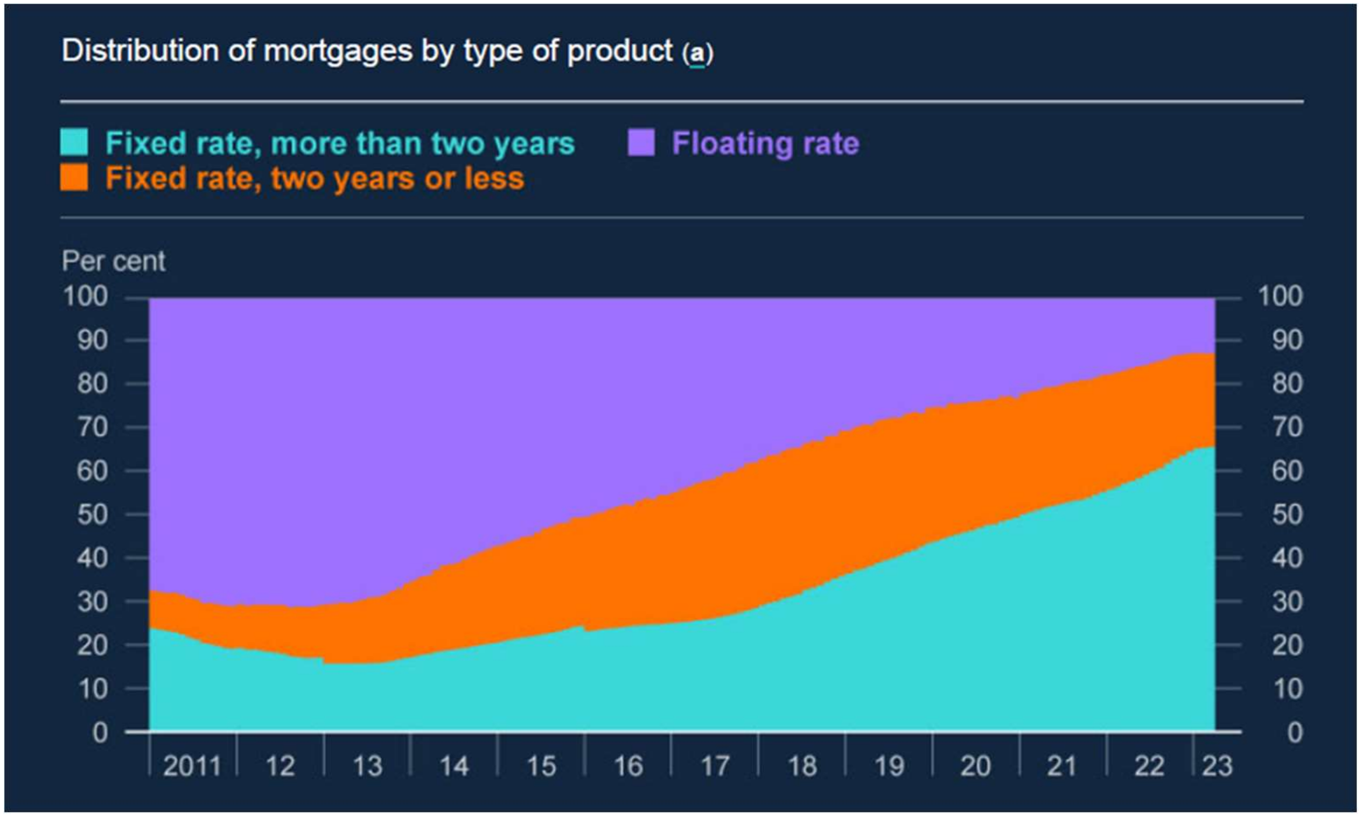
- Producer price inflation for goods is now falling back rapidly, but is only beginning to turn for food and supply chain lags can be long.

Markets pricing in Bank Rate rising to 4¾% before declining



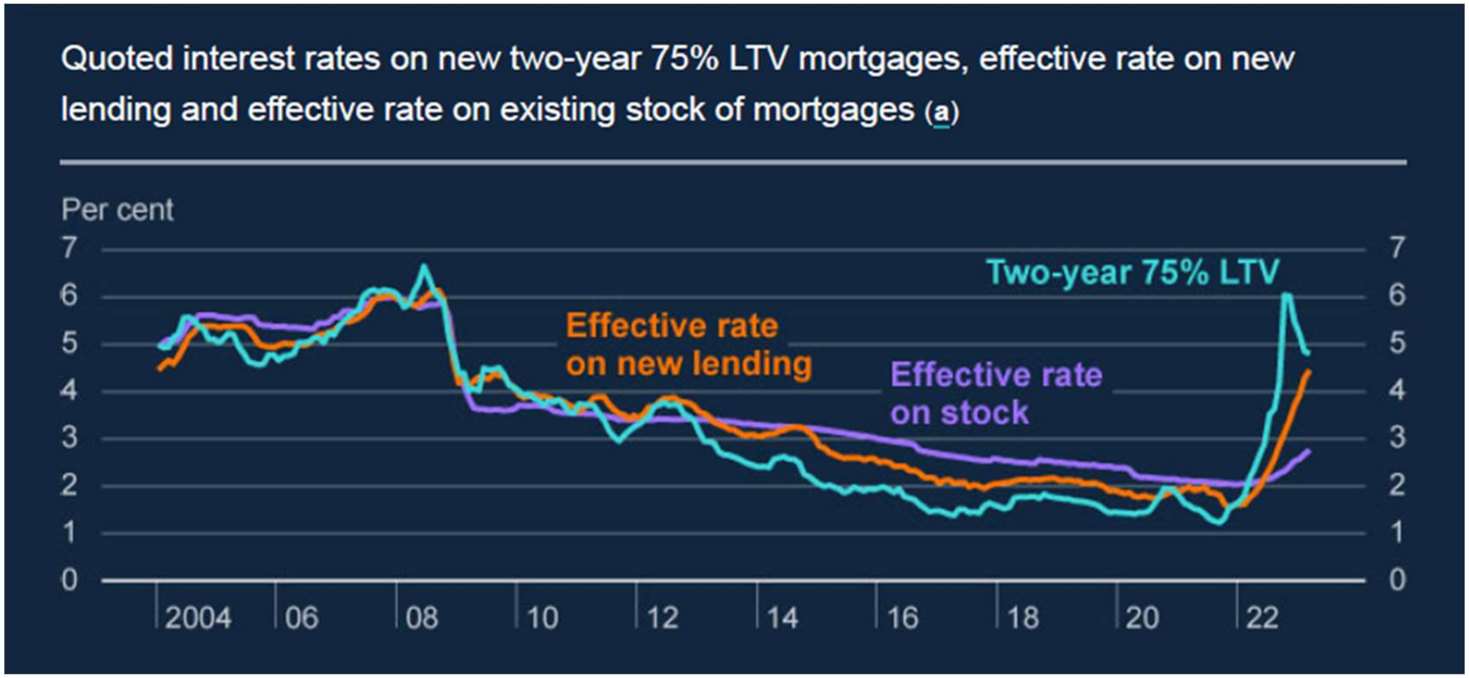
- MPC's forecasts are conditioned on a market path that rises to 4¾% before declining to around 3½% in three-years' time

The share of fixed rate mortgages has increased



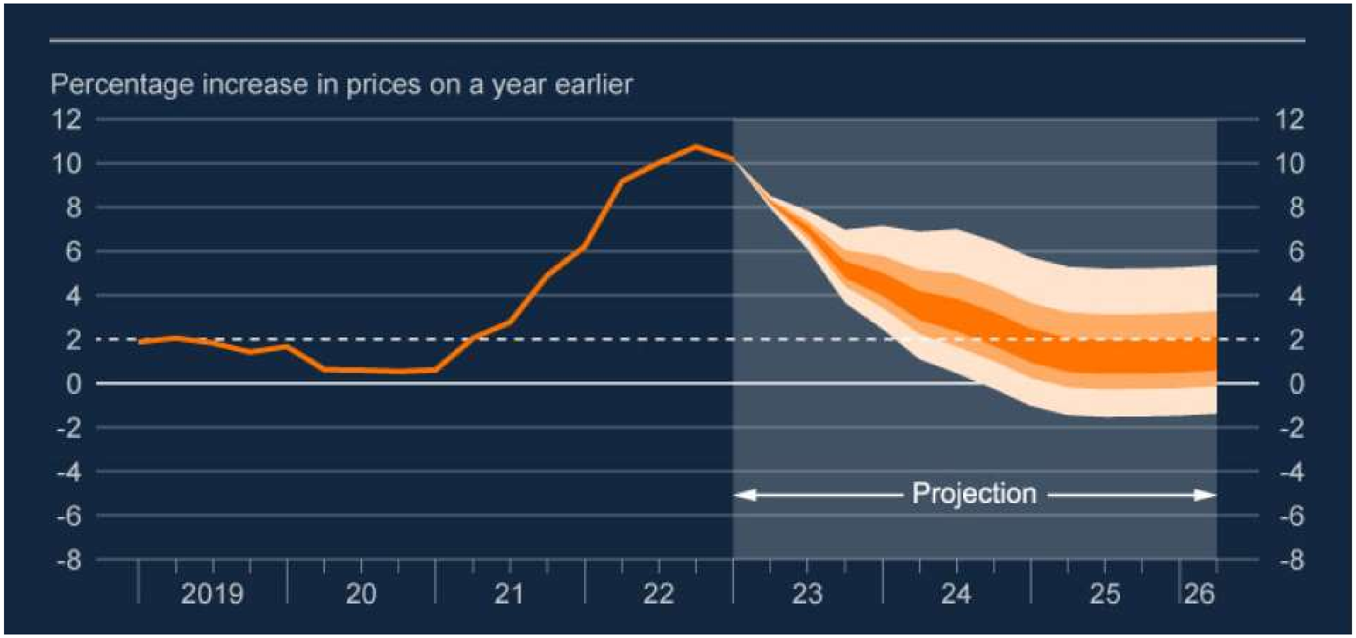
- Most mortgages are now fixed for 2-5 years - a substantial change on previous hiking cycles

Rates on the stock of mortgages have risen by much less than those on new mortgages



- The average rate on the stock of outstanding mortgages (in purple) has only risen a little since early 2022.

CPI inflation projection based on the market interest rate path



- In the modal forecast, domestic price pressures ease back alongside the fading in energy and other external cost pressures.
- CPI inflation falls below target to just over 1% at years 2-3.
- MPC see very large upside risks to that– the mean forecast is closer to target.

Messages from the May Monetary Policy Summary

- The MPC have increased Bank Rate by 0.25pps to 4.5%, continuing to address risks of more persistent strength in domestic wages and prices.

- Will continue to monitor closely indications of persistent inflationary pressures, including labour market tightness, wage growth and services price inflation. If evidence of more persistent pressures, then further tightening would be required.

- MPC will adjust Bank Rate as necessary to return inflation to 2% target sustainably in the medium term.