BANK OF ENGLAND

Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 6 May 2020

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These are the minutes of the Monetary Policy Committee meeting ending on 6 May 2020.

They are available at https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2020/may-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 17 June will be published on 18 June 2020.

Monetary Policy Summary, May 2020

Authorities around the world are taking action to halt the spread of the Coronavirus (Covid-19) pandemic and to support economic activity.

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 is to respond to the severe economic and financial disruption caused by the spread of Covid-19. At its meeting ending on 6 May 2020, the MPC voted unanimously to maintain Bank Rate at 0.1%. The Committee voted by a majority of 7-2 for the Bank of England to continue with the programme of £200 billion of UK government bond and sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, to take the total stock of these purchases to £645 billion. Two members preferred to increase the target for the stock of asset purchases by an additional £100 billion at this meeting.

The spread of Covid-19 and the measures to contain it are having a significant impact on the United Kingdom and many countries around the world. Activity has fallen sharply since the beginning of the year and unemployment has risen markedly.

Economic data have continued to be consistent with a sudden and very marked drop in global activity. Oil prices have been volatile. There have, however, been tentative signs of recovery in domestic spending in China, and this is likely to be echoed in other countries that have started to relax Covid-related restrictions on economic activity. Financial markets have recovered somewhat over recent weeks and risky asset prices have picked up from their lows in mid-March. This in part reflects the actions taken by authorities in the United Kingdom and elsewhere. Global financial conditions have, nevertheless, remained tighter than prior to the outbreak of Covid-19.

The timeliest indicators of UK demand have generally stabilised at very low levels in recent weeks, after unprecedented falls during late March and early April. Payments data point to a reduction in the level of household consumption of around 30%. Consumer confidence has declined markedly and housing market activity has practically ceased. According to the Bank's Decision Maker Panel, companies' sales are expected to be around 45% lower than normal in 2020 Q2 and business investment 50% lower. There has been widespread take-up of the Coronavirus Job Retention Scheme. Nevertheless, sharp increases in benefit claims are consistent with a pronounced rise in the unemployment rate.

CPI inflation declined to 1.5% in March and is likely to fall below 1% in the next few months, in large part reflecting developments in energy prices.

The unprecedented situation means that the outlook for the UK and global economies is unusually uncertain. It will depend critically on the evolution of the pandemic, and how governments, households and businesses respond to it. Recognising these uncertainties, the MPC has constructed a plausible illustrative economic scenario in the accompanying May *Monetary Policy Report*. This scenario is based on a set of stylised assumptions about the pandemic and the responses of governments, households and businesses, and, as usual, on the prevailing levels of asset prices and the market path for interest rates. While the scenario is highly conditional, it helps to illustrate the potential impact of Covid-19 on the economy and the channels through which the impact is felt. The *Report* also includes a number of estimates of the sensitivity of the economy to a selection of key variables, which, taken alongside the scenario, serve to illustrate the important drivers of the outlook.

The illustrative scenario incorporates a very sharp fall in UK GDP in 2020 H1 and a substantial increase in unemployment in addition to those workers who are furloughed currently. Given the assumed path for the relaxation of social distancing measures, the fall in GDP should be temporary and activity should pick up relatively rapidly. Nonetheless, because a degree of precautionary behaviour by households and businesses is assumed to persist, the economy takes some time to recover towards its previous path. CPI inflation is expected to fall further below the 2% target during the second half of this year, largely reflecting the weakness of demand.

As set out in the accompanying *interim Financial Stability Report*, the Financial Policy Committee (FPC) has assessed the risks to UK financial stability and the resilience of the UK financial system to the economic and market shocks associated with Covid-19. Drawing on the MPC's illustrative scenario, the FPC judges that the core banking system has capital buffers more than sufficient to absorb losses and, supported by government guarantees for new lending and Bank of England funding, the capacity to provide credit to support the UK economy.

The MPC has statutory objectives to maintain price stability and, subject to that, to support the economic policy of the Government including its objectives for growth and employment. In the current circumstances, and consistent with the MPC's remit, monetary policy is aimed at supporting businesses and households through the crisis, and limiting any lasting damage to the economy.

Since the onset of the Covid-19 shock, the MPC has, complementing the responses of other parts of the Bank of England and the UK Government, taken a number of actions to fulfil its mandate. The Committee has reduced Bank Rate to 0.1%; has introduced a Term Funding scheme with additional incentives for Small and Medium-sized Enterprises (TFSME); and announced a £200 billion increase in the stock of UK government bond and sterling non-financial investment-grade corporate bond purchases, to be carried out as soon as operationally possible and consistent with improved market functioning. The Committee notes that the stock of asset purchases will reach £645 billion by the beginning of July, at the current pace of purchases. The Committee continues to monitor closely a range of indicators of market functioning.

In the illustrative scenario, the recovery in economic activity is relatively rapid and inflation rises to around the 2% target, conditional on the scenario assumptions that include a gradual easing in social distancing, and supported by the very significant monetary and fiscal stimulus. Relative to the scenario, the Committee assesses that the balance of risks to the economic outlook lies to the downside.

At this meeting, the Committee judges that the existing stance of monetary policy is appropriate. The MPC will continue to monitor the situation closely and, consistent with its remit, stands ready to take further action as necessary to support the economy and ensure a sustained return of inflation to the 2% target.

Minutes of the Monetary Policy Committee meeting ending on 6 May 2020

1 Before turning to its immediate policy decision, the Committee discussed: the international economy; financial markets; credit conditions and monetary developments; demand and output; and supply, costs and prices.

The international economy

2 Economic data had been consistent with a sudden and very marked drop in global activity. Bank staff estimated that UK-weighted world GDP had fallen by around 4% in 2020 Q1 and the illustrative scenario in the May *Monetary Policy Report* incorporated a much larger decline in global output in the second quarter. There had been tentative signs of recovery in domestic spending in China, however, and this was likely to be echoed in other countries that had recently started to relax Covid-related restrictions on economic activity.

3 According to the preliminary flash estimate, euro-area GDP had fallen by 3.8% in 2020 Q1. Euro-area PMIs had declined sharply again in April, particularly in the service sector, and the European Commission's economic sentiment indicator had decreased to its lowest level since March 2009. Timely employment indicators had been weak, although the take-up of short-time working schemes in many euro-area economies would mitigate the extent to which weaker labour demand would result in unemployment.

4 Since the MPC's previous meeting, the European Council had endorsed the agreement of the Eurogroup on three safety nets, for workers, businesses and sovereigns, amounting to a package worth €540 billion, and had agreed to work towards establishing a recovery fund. There would be a significant aggregate loosening of fiscal policy by euro-area governments, although there had been significant variation in the extent of the response across countries. With infection and fatality rates appearing to have peaked, a number of larger euro-area countries had announced plans to ease Covid-related restrictions on economic activity gradually from the beginning of May.

5 According to the advance estimate, US GDP had declined by 1.2% in 2020 Q1. Personal consumption and non-residential fixed investment had been the main drivers of the contraction, falling by 1.9% and 2.2% respectively. Initial jobless claims data had continued to increase substantially, by around 4 million per week in mid-April, suggesting a very significant increase in the unemployment rate. According to the Conference Board, consumer confidence had weakened significantly in April, with the present situation index recording its largest fall on record. The expectations index had risen somewhat, however, perhaps related to respondents expecting restrictions on economic activity to be lifted shortly.

6 At the end of March, the US government had passed the Coronavirus Aid, Relief, and Economic Security (CARES) Act, which would provide around $2 trillion of fiscal support. This had included payments to individuals and loans to small businesses via the Paycheck Protection Program (PPP), an increase in unemployment insurance, and new funding for the health system and for state and local governments. The US government had subsequently approved an additional fiscal package of around $500 billion, including a top-up

of the funds available for the PPP. The Federal Reserve had taken a wide range of complementary actions, including providing up to $2.3 trillion in loans to support the economy.

7 According to the National Bureau of Statistics (NBS), quarterly GDP in China had fallen by 9.8% in 2020 Q1 and nominal GDP in Hubei province, where Covid-related restrictions had been most severe, had declined by 37% on a year earlier. The largest falls in recorded output had been in the accommodation and catering, wholesale and retail, and construction sectors. Restrictions on activity had started to be lifted in February. Chinese PMIs had bounced back in March and had generally maintained those gains in the latest April data. There had been a sharp rebound in official industrial production data in March. In contrast, March retail sales growth and some other more timely indicators of consumption had only picked up slightly so far, as households remained cautious. Weak activity in the rest of the world was also likely to be limiting the pace of recovery, consistent with the large fall in the new export orders sub-index of the NBS manufacturing PMI in April.

8 The Committee discussed how early evidence from China and other countries on the impact of starting to relax Covid-related restrictions might inform the economic outlook for the United Kingdom in due course. First, such measures were likely to be removed only gradually and so activity would continue to be affected for some time. Activity in service sectors would continue to be most impacted by some form of restrictions. These sectors both made up large parts of GDP in developed economies and tended to be the most labour-intensive. Second, lingering concerns about the virus among households were likely to delay a recovery in consumption spending. This was particularly relevant for forms of spending on social activities that had weakened prior to the implementation of official social distancing measures, and which appeared so far to have remained weaker than usual, even after the lifting of some measures. Third, in a highly integrated global economy, any recovery might be slow until a sufficient number of economies had re-opened and global supply chains had been re-established.

9 Oil prices had been volatile. The price of the May 2020 West Texas Intermediate (WTI) futures contract had been temporarily negative prior to its expiry, due in part to the tightness of storage capacity at Cushing, Oklahoma. The June WTI contract had subsequently fallen sharply as some large investors reduced their exposures, but had then rebounded. Dollar Brent oil prices, the futures contracts of which could be settled in cash, had been less volatile, but were still substantially lower than at the time of the January *Report*.

10 These recent developments in oil markets had reflected excess oil supply as the collapse in global demand had been greater than the cuts in oil output announced recently by OPEC and other major producers. The oil price futures curve was now significantly upward sloping. This was consistent with market expectations that the current excess supply of oil, though significant, would ultimately prove temporary.

11 The sharp fall in oil prices over recent months would feed through to consumer prices over time, via both energy prices and other indirect channels. The flash estimate of euro-area HICP inflation had fallen to 0.4% in April, while inflation excluding energy, food, alcohol and tobacco had declined slightly to 0.9%. In the United States, headline PCE inflation had fallen to 1.3% in March and core PCE inflation had declined marginally, to 1.7%.

Financial markets

12 Since the MPC's previous meeting, financial markets had recovered somewhat, helped by the actions taken by authorities in the United Kingdom and elsewhere. Risky asset prices had picked up from their lows in mid-March, accompanied by declines in government bond yields. This nevertheless meant that financial conditions had remained tighter than at the time of the January *Monetary Policy Report*, and markets had continued to be volatile. Market functioning had improved appreciably relative to the turbulence seen in mid-March, although measures of liquidity had generally not returned to their levels prior to that period. Conditions had continued to be strained in some markets, and Libor settings had remained elevated.

13 Major global equity price indices had increased since the MPC's previous meeting ending on 25 March, and by over 15% since the lows in mid-March, when many central banks had introduced measures to ease policy and restore liquidity to key financial markets. The recent recovery was estimated to have been accounted for mainly by falls in equity risk premia, as analysts' expectations of corporate earnings had continued to drift down, for both 2020 and to a lesser extent for 2021. Measures of equity market implied volatility, such as the VIX, had remained elevated relative to historical averages, despite having fallen back sharply from the peaks seen in mid-March. Options prices suggested 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 In corporate bond markets, both investment-grade and high-yield spreads had fallen back following the global policy actions in mid-March, but had remained materially higher than at the time of the January *Report*, consistent with a deterioration in credit risk. The high-yield market had been supported by the Federal Reserve's announcement that it would include high-yield exchange-traded funds and recently downgraded issuers' bonds in the scope of its asset purchases. Investment-grade corporate bond issuance had picked up appreciably, in part reflecting the impact of central bank policy actions, as well as precautionary cash-raising by firms with stronger balance sheets. The primary market for sub-investment grade corporate bonds had also re-opened.

15 Market contacts indicated that investors who, in March, had shifted portfolio holdings away from risky assets and government bonds towards cash, particularly US dollars, had partly reversed those moves. This had led to an unwinding of the previous appreciation of the US dollar, and a corresponding appreciation of other currencies, including sterling, which was 5% higher than at the time of the MPC's previous meeting on a trade-weighted basis, though still 3% lower than at the time of the January *Report*.

16 Consistent with that portfolio shift, short and longer-term advanced economy bond yields had fallen since the MPC's previous meeting and, despite having picked up sharply during the turbulence of mid-March, were now below their levels at the time of the January *Report*. Euro-area periphery countries' sovereign debt spreads to German Bunds had been fairly volatile, generally remaining below recent peaks, but more elevated than in the pre-Covid period.

17 At its meeting on 29 April, 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. The Federal Reserve had reduced its purchase rate of Treasury securities from approximately $75 billion per day on average

in late March to $8 billion in early May. The ECB Governing Council had left policy unchanged at its 30 April meeting, broadly in line with expectations, had announced new pandemic emergency longer-term refinancing operations and had recalibrated its existing targeted longer-term refinancing operations.

18 Conditions in the UK gilt market had improved appreciably following the MPC's announcement on 19 March of a policy package including an additional £200 billion of asset purchases. This improvement also appeared to have reflected global influences, including the impact of policy actions in other major advanced economies. Nevertheless, although bid-ask spreads in the gilt market had fallen, they had continued to be slightly more elevated than prior to mid-March. Ten-year yields were around 25 basis points lower than at the time of the MPC's previous meeting, and around 50 basis points lower than at the time of the January *Report*. Market contacts' modal projection was that the MPC would announce a further increase in the total stock of purchased assets in the coming months.

19 UK wholesale unsecured bank funding costs had fallen back substantially since the MPC's previous meeting, but had remained elevated. This was expected to have only a limited impact on UK banks' overall funding costs, however, for several reasons: wholesale unsecured funding made up a relatively small share of UK banks' total funding; many banks had already built up considerable surplus liquidity; and the Bank of England had introduced a Term Funding scheme with additional incentives for SMEs (TFSME), which was intended in part to provide participants with a cost-effective source of funding. Bank equity prices had fallen slightly since the MPC's previous meeting, despite the pickup in the wider FTSE All-Share index.

Credit conditions and monetary developments

20 There had been a very sharp increase in both broad money and sterling lending to the UK private sector in March, an early indicator of exceptional financial flows. Sterling money holdings by households, private non-financial businesses (PNFCs) and non-intermediate financial companies, known as M4ex, had increased by £57 billion, and sterling borrowing from banks, M4Lex, had increased by £55 billion, which were respectively around six and eleven times higher than the average increase of the previous six months. Net finance raised by companies had been £32 billion in March, with bank loans to larger firms accounting for most of this unusually large figure. Corporate deposits had risen by a similar amount to the increase in bank lending to corporates, suggesting precautionary borrowing by larger firms that had drawn down materially from their existing bank facilities.

21 Effective variable interest rates on new lending to PNFCs had fallen by 17 basis points in March. The impact of the reductions in Bank Rate on existing borrowing rates faced by some PNFCs had been limited by the recent widening in the spread between three-month Libor and Bank Rate in the second half of March, which had offset much of the cut in Bank Rate.

22 As discussed in the May *Monetary Policy Report* and *interim Financial Stability Report*, demand for credit from businesses had picked up considerably, as those affected by the crisis had sought to build liquidity buffers and to meet cash-flow shortfalls, given declining revenues. Around two thirds of business in the Bank's April

Decision Maker Panel (DMP) had reported that their demand for credit in 2020 Q2 would be higher than otherwise expected as a result of Covid-19. Lenders responding to the Q1 *Credit Conditions Survey* conducted in early March had reported that they expected corporate demand for credit to increase in Q2, for firms of all sizes. These had been the most positive net survey percentage balances on record.

23 The Bank's Agents' contacts had reported that banks had largely maintained credit supply for existing customers, by renewing loans and overdrafts, relaxing covenants and granting repayment holidays. Nevertheless, credit availability was reported to be tight in the sectors worst-affected by Covid-19, for which banks were said to be reluctant to grant new loans. Contacts had also reported emerging supply constraints from non-bank lenders, which played an important role in specific areas of lending, such as the provision of short-term finance for working capital to SMEs. Other surveys had also suggested that some borrowers faced constraints. Nearly 30% of firms had reported to the Deloitte CFO Survey that credit availability had worsened, and around 10% of businesses responding to the DMP had expected to want more credit but did not think it would be available.

24 The availability of credit was being supported directly by a number of Government schemes intended to help companies to bridge across the economic disruption, including the Coronavirus Business Interruption Loan Scheme (CBILS) for SMEs and its equivalent for larger businesses (CLBILS), the Covid Corporate Financing Facility (CCFF), and the Bounce Back Loans Scheme (BBLS) for smaller businesses. As of 6 May, £17.7 billion of commercial paper had been purchased by the CCFF and, as of 4 May, UK Finance data showed that £5.3 billion of funds had been provided under CBILS. Early indications had pointed to a sizeable number of applications for the BBLS.

25 Households' bank deposits had risen markedly in March, as the lockdown had compelled some of those with unaffected incomes to accumulate unplanned savings, or prompted additional precautionary savings. Interest rates on new household sight and time deposits had fallen, on average, by 16 and 34 basis points respectively following the recent reductions in Bank Rate.

26 In contrast to the strength of lending to corporates, the flow of lending to households had been weak. The net flow of consumer credit had turned sharply negative in March, a repayment of £3.8 billion.

27 Housing market activity had largely ceased by the end of March, and the demand for new mortgages had fallen accordingly, with mortgage approvals in March as a whole falling by more than 20% compared with the previous month. The Nationwide house price index had increased in April, by 1.5% on a three-month-on-three-month basis, but the majority of transactions in this sample had related to mortgage applications commenced prior to the lockdown. In coming months, the ability to produce house price indices would depend on there being sufficient transactions that were representative of the wider housing market.

28 The recent 65 basis point reduction in Bank Rate had been, or was likely to be shortly, passed through in full to existing tracker and Standard Variable Rate mortgages. Supervisory intelligence from the PRA suggested that borrowers accounting for around 15-20% of mortgage books had applied for, or been granted, a payment holiday, which would help cushion the shock to incomes from the pandemic for these households. Quoted rates on most new fixed-rate mortgage products had, so far, been little changed. Although the falls in risk-free rates

were likely to be already having some influence on the price of new mortgage lending, pricing decisions were also likely to have been affected by the impact of Covid-19, including on the housing market and mortgage lending capacity.

Demand and output

29 Business surveys had continued to report sharp declines in UK activity as the effects of the lockdown had spread through the economy. The IHS/Markit composite output PMI had fallen to a record low of 13.8 in April, with both the services and manufacturing sectors reporting unprecedented declines. The construction PMI had also fallen to a record low. Although the contraction in output recorded by the CBI monthly composite output balance, relating to the three months to April, had been less severe than those registered during the height of the financial crisis, the balance relating to expected output over the next three months had hit its lowest ever level, suggesting that worse activity readings were to come. The weekly BCC survey had reported small improvements in its output balance in recent weeks, but was still consistent with sharp declines in activity.

30 Although Bank staff routinely used business survey data to infer early estimates of GDP growth, such data were likely to provide a less accurate signal in the event of very significant changes in activity. This was because they reflected the proportion of respondents that had seen their output fall, rather than the average size of those declines. The 2020 Q1 estimate of a fall in GDP of around 3% had been informed by a wide range of high-frequency indicators, as set out in the May *Monetary Policy Report*.

31 The Office for National Statistics was likely to have more difficulty measuring GDP and other macroeconomic variables in the current circumstances. Early estimates of GDP often contained gaps that were filled with statistical estimates, and the latter were likely to be difficult to produce with precision following such a sharp shift in the economy. There were also likely to be more gaps in the data than usual, as response rates to the ONS's business surveys were likely to fall. ONS staff had been keeping Bank staff informed about these difficulties and their plans to deal with them.

32 Household demand had been hit hard. Payments data had pointed to a fall in the level of consumption of around 30%. These expenditure trends had flattened out during April. Consistent with this, a new weekly survey conducted by Ipsos Mori on behalf of the Bank of England had suggested some stabilisation in household spending during the past three weeks: around 10% of households had reported having spent a lot less than usual, compared with around 25% in the previous two weeks.

33 Timely indicators of social consumption had remained flat at very low levels. Payments data relating to airlines, hotels, restaurants and entertainment had all settled at around 20% or less of their pre-crisis levels. Flights from the UK's main airports had been more than 90% lower than normal, with car traffic around major airports down by around 85%. Retail footfall had fallen by more than 80% relative to pre-crisis levels.

34 Household purchases of durable goods, which could be delayed, had also dropped sharply, although there had been signs of a moderate recovery in the most recent data. Sales by non-food retailers had

registered their largest ever monthly fall in March. Household spending on vehicles had been close to zero, as car dealerships had closed. New car registrations had dropped by 97% in the year to April.

35 Consumer confidence had declined markedly. The April reading of the GfK/EC consumer confidence index had fallen by the largest amount on record, and was close to the lows last seen during the euro-area crisis. Daily consumer confidence data from Morning Consult had indicated that confidence had levelled out at these low levels. Consumers had reported, in particular, pessimism about the general economic situation and that now was not a good time to make a major purchase. Households' assessment of their own financial situation had also deteriorated, which resonated with the finding in the Bank/Ipsos Mori survey that nearly 40% of adults had said that their income had fallen because of Covid-19, and around a quarter of respondents had reported financial difficulty of some kind.

36 Business confidence had also been severely depressed, with negative implications for business investment. The Lloyds Business Barometer had fallen sharply in April, close to an all-time low. According to the weekly ONS Business Impact of Coronavirus Survey, nearly 60% of firms had experienced unusually low turnover and around a quarter had paused trading. The Bank's Decision Maker Panel had reported that sales were expected to be around 45% lower than normal in 2020 Q2, and investment 50% lower. Although, in normal times, changes in investment intentions might be expected to be realised fairly gradually, the abrupt closure of many production and construction businesses meant that the Q2 drop in investment spending was likely to be sharp. Housing investment was also likely to see a marked drop.

37 The impact of the crisis on net trade was unclear, but various real-time guides suggested that both exports and imports had fallen sharply.

38 There had recently been tentative signs of a pickup in transactions though payment systems and car journeys, possibly reflecting a small uptick in economic activity. The Bank's Agents had also reported that some businesses that had closed voluntarily, such as DIY stores and takeaway food outlets, had started to reopen. After making adjustments to working practices to accommodate social distancing rules, a growing number of manufacturing companies, for example in automotive, heavy industry and construction materials, planned to resume production over the coming weeks, albeit at lower volumes initially. A number of construction contacts, including those in housebuilding and commercial construction, had told the Agents that they planned to resume activity in the coming weeks too.

Supply, costs and prices

39 Annual CPI inflation had fallen to 1.5% in March, from 1.7% in February. This was 0.3 percentage points lower than had been expected at the time of the January *Monetary Policy Report*. The main downside news had come from energy, clothing and footwear, and household goods. With the recent falls in oil prices, headline CPI inflation was likely to fall below 1% over the next few months, which would require an exchange of letters between the Governor and the Chancellor of the Exchequer.

40 Social distancing, and the resulting contraction in consumer spending, would present some challenges for the Office for National Statistics in compiling consumer price estimates. Hitherto, 56% of the CPI basket by weight had drawn on price collection from directly within retail premises. The ONS had increased price collection via the internet, telephone and email. But social distancing would nonetheless reduce the sample size for the CPI. In addition, a range of prices was no longer available as certain activities, such as eating in restaurants, had almost entirely ceased altogether. This problem was not unique to the United Kingdom, and the ONS would be following international guidelines as well as its own standard practices to deal with these missing prices. Nonetheless, the accuracy of inflation data could be affected as long as these challenges persisted.

41 Medium-term measures of UK inflation compensation from financial markets, such as the five-year inflation swap rate, five years forward, had fallen by around 15 basis points since the January MPC meeting. Equivalent measures in the United States and the euro area had also fallen. Beyond financial markets, the Citi/YouGov survey of household inflation expectations had, despite the lower oil price, reported a marked rise in one-year-ahead expectations in March that had been sustained in the April survey, although the five-year-ahead measure had been little changed. The Bank’s Survey of Economic Forecasters, in contrast, had shown a pronounced rise in the proportion of forecasters expecting inflation to drop below 1% in a year’s time.

42 There was likely to be a large rise in unemployment and underemployment, as workers were laid off or furloughed. Claims for Jobseeker’s Allowance had risen markedly, and although there was no straightforward mapping from Universal Credit claims to unemployment, the sharp increase in claims was likely to portend a pronounced rise in the unemployment rate, perhaps to around 9% in the second quarter. The slump in labour demand had also been seen in reduced job vacancies, with data from Indeed recording online vacancy postings at around 40% of pre-crisis levels. The REC Report on Jobs for April had shown a sharp fall in the demand for staff, with the indices for permanent staff placings and temporary staff billings falling to record lows of 5 and 10 respectively.

43 There had remained some uncertainty about how many workers would be furloughed under the Coronavirus Job Retention Scheme (CJRS), but actual and planned take-up of the scheme appeared to have been substantial. The ONS’s Business Impact of Coronavirus Survey had reported that the 75% of firms still trading had furloughed around 20% of their workforce, while the 25% of firms that were not trading had furloughed around 80% of their workforce. Separately, the BCC had reported that around three-quarters of companies had furloughed at least some of their workforce, with 14% of firms furloughing their entire workforce. Early data had suggested that applications for furlough had been received from 800,000 companies covering over 6 million jobs. The number of people furloughed might be a little lower, though, as some could have more than one furloughed job. Although the CJRS would significantly limit job losses, it would cover at most 80% of an individual’s earnings and, according to reports from the Bank’s Agents, only a minority of firms had supplemented that. Average pay was therefore likely to decline markedly.

The immediate policy decision

44 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 was to respond to the severe economic and financial disruption caused by the spread of Covid-19.

45 The unprecedented situation meant that the outlook for the UK and global economies was unusually uncertain. It would depend critically on the evolution of the pandemic, and how governments, households and businesses responded to it. Recognising these uncertainties, the MPC had constructed a plausible illustrative economic scenario in the accompanying May *Monetary Policy Report*. This scenario was based on a set of stylised assumptions about the pandemic and the responses of governments, households and businesses, and, as usual, on the prevailing levels of asset prices and the market path for interest rates. While the scenario was highly conditional, it helped to illustrate the potential impact of Covid-19 on the economy and the channels through which the impact was felt. The *Report* also included a number of estimates of the sensitivity of the economy to a selection of key variables, which, taken alongside the scenario, served to illustrate the important drivers of the outlook.

46 As set out in the accompanying *interim Financial Stability Report*, the Financial Policy Committee (FPC) had assessed the risks to UK financial stability and the resilience of the UK financial system to the economic and market shocks associated with Covid-19. Drawing on the MPC's illustrative scenario, the FPC judged that the core banking system had capital buffers more than sufficient to absorb losses and, supported by government guarantees for new lending and Bank of England funding, the capacity to provide credit to support the UK economy.

47 The MPC reviewed economic developments since its previous meeting, and the latest information on the impact of its own and others' policy actions.

48 Economic data had continued to be consistent with a sudden and very marked drop in global activity. The impact on many of the economies affected by Covid-19 had been compounded by the fact that so many countries had been affected at the same time. Oil prices had been volatile. There had been tentative signs of recovery in domestic spending in China, however, and this was likely to be echoed in other countries that had started to relax Covid-related restrictions on economic activity.

49 The illustrative scenario in the May *Report* incorporated a fall in UK-weighted world growth from 2% in 2019 to -13% in 2020. Growth increased strongly in 2021, to 14%, reflecting the recovery in activity, before growing by 4% in 2022. The initial fall in world GDP was accompanied by a large reduction in world trade. The Committee noted that the outlook for world trade and foreign domestic investment flows was particularly uncertain.

50 Financial markets had recovered somewhat over recent weeks and risky asset prices had picked up from their lows in mid-March. This in part reflected the actions taken by authorities in the United Kingdom and elsewhere. Market functioning had improved appreciably relative to the turbulence seen in mid-March, although measures of liquidity had generally not returned to their levels prior to that period. Conditions had continued to

be strained in some markets, and Libor settings remained elevated. There remained a pronounced left-hand tail in the implied risk-neutral distribution of future equity prices, although that tail had been reduced following policy actions. Global financial conditions had remained tighter than prior to the outbreak of Covid-19.

51 The very large increases in lending to the UK private sector and in broad money holdings in March were an early indicator of exceptional financial flows. There had been substantial precautionary borrowing by larger firms that had drawn down materially from their existing bank facilities.

52 The availability of credit was being supported directly by a number of Government schemes intended to help companies to bridge across the economic disruption. As of 6 May, the Covid Corporate Financing Facility (CCFF), for which the Bank was acting as HM Treasury's agent, had purchased £17.7 billion of commercial paper from companies who were making a material contribution to the UK economy. Total drawing capacity across firms that had completed their applications to the scheme had now reached around £50 billion. As outlined in the letter that the Governor had sent to the Chancellor of the Exchequer on 17 March, the MPC would take the size of the CCFF into account when it took its decisions on the appropriate monetary policy stance necessary to fulfil its remit.

53 The timeliest indicators of UK demand had generally stabilised at very low levels in recent weeks, after unprecedented falls during late March and early April. Payments data had pointed to a reduction in the level of household consumption of around 30%. Consumer confidence had declined markedly and housing market activity had practically ceased. According to the Bank's Decision Maker Panel, companies' sales were expected to be around 45% lower than normal in 2020 Q2 and business investment 50% lower. There had been widespread take-up of the Coronavirus Job Retention Scheme. Nevertheless, sharp increases in benefit claims were consistent with a pronounced rise in the unemployment rate, although it was difficult to map precisely from claims to unemployment.

54 The illustrative scenario in the May *Report* incorporated a very sharp fall in UK GDP in 2020 H1 and a substantial increase in unemployment in addition to those workers who were furloughed currently. UK GDP was expected to fall by around 25% in Q2, and the unemployment rate was expected to rise to around 9%. There were large uncertainty bands around these estimates. Beyond this quarter, the outlook would depend on the evolution of the pandemic and how households, businesses and government responded to it, which were especially difficult to quantify with any degree of accuracy.

55 The fall in activity should nevertheless be temporary, and activity should pick up relatively rapidly as social distancing measures were relaxed. In the illustrative scenario, the economy took some time to recover towards its previous path, however, because a degree of precautionary behaviour by households and businesses was assumed to persist, with risks skewed to the downside.

56 CPI inflation had declined to 1.5% in March and was likely to fall below 1% in the next few months, in large part reflecting developments in energy prices. This would require an exchange of letters between the Governor and the Chancellor of the Exchequer. Measurement challenges would temporarily increase the noise in the inflation data, and affect the nature and behaviour of the index relative to a normal period. The MPC would

continue to monitor closely developments in indicators of inflation expectations, including those of households, businesses and financial markets.

57 In the illustrative scenario in the May *Report*, CPI inflation was expected to fall further during the second half of this year, largely reflecting the weakness of demand. Further out, inflation rose to around the 2% target as demand recovered. Sectoral heterogeneity in movements of demand relative to supply suggested that the standard aggregate relationships might be a less reliable guide than usual to how changes in the output gap and unemployment would affect CPI inflation.

58 Since the onset of the Covid-19 shock, the MPC had, complementing the responses of other parts of the Bank of England and the UK Government, taken a number of actions to fulfil its mandate, including reducing Bank Rate to 0.1%, introducing a Term Funding scheme with additional incentives for Small and Medium-sized Enterprises (TFSME) and increasing the total stock of asset purchases by £200 billion.

59 The TFSME, which had opened to drawings on 15 April, was reinforcing the transmission of the reductions in Bank Rate and providing participants with a cost-effective source of funding. It was also giving an incentive to banks to provide credit, particularly to SMEs, by providing an additional five pounds of funding for every pound of positive net lending to them. Over 30 banks and building societies had applied to participate in the scheme to date, and their plans suggested that the scheme would provide in excess of £100 billion in term funding. As of 6 May, participants had drawn £11 billion from the TFSME.

60 The TFSME included additional incentives to lend to SMEs defined as companies with a turnover of up to £25 million. The TFSME documentation had been updated on 20 April to allow sterling loans made through CBILS to companies with a turnover of up to £45 million to be included in reported lending to SMEs. To support lending through the Government's new Bounce Back Loans Scheme (BBLS), a further change to the design of the TFSME had been announced on 2 May. TFSME participants would in future be able to extend the term of some of the cheap four-year funding they had accessed via the scheme to align with the six-year term of loans made through the BBLS. The MPC had been briefed on the monetary policy impact of these changes.

61 Initial evidence had suggested that interest rates on bank lending to some households and businesses had fallen, although it was too early to assess the wider economic impact of the recent reductions in Bank Rate. Borrowing costs had fallen on most existing floating-rate mortgages. Although reductions in risk-free rates were already having an influence on new mortgage lending rates, banks' pricing decisions were also likely to have been affected by the impact of Covid-19, including on the housing market and mortgage lending capacity. In addition, pass-through to corporate lending rates had been limited by the recent widening in the spread between three-month Libor and Bank Rate.

62 At its special meeting on 19 March, the MPC had announced a £200 billion increase in the stock of UK government bond and sterling non-financial investment-grade corporate bond purchases, to be carried out as soon as was operationally possible and consistent with improved market functioning. This action had been taken partly to guard against the tightening in financial conditions at that time. The MPC judged that, had that tightening persisted, it would have put the Committee's objectives at risk.

63 Additional asset purchases had helped to improve liquidity and reduce interest rates in the gilt market. Gilt yields across all maturities were lower than the levels seen in mid-March. In addition, spreads between bid and offer prices had fallen back from the elevated levels seen in mid-March.

64 Conditions in corporate bond markets had also improved since mid-March. The Bank of England had begun purchases of investment-grade corporate bonds on 7 April. As set out in the Market Notices issued on 2 April and 1 May, the Bank would purchase at least an additional £10 billion of corporate bonds, taking the stock of purchased corporate bonds to at least £20 billion. As first set out in 2016, the Corporate Bond Purchase Scheme was designed to achieve a balanced portfolio of bonds across eligible issuers and sectors, so that a representative portion of the market was purchased and that the purchases did not influence the allocation of credit to particular companies or sectors of the economy.

65 As of 6 May, the total stock of asset purchases had reached £528 billion, an increase of £83.5 billion as part of the current programme of asset purchases. Within that increase, £81 billion of UK government bonds, and £2.5 billion of investment-grade corporate bonds, had been purchased over recent weeks. The Committee noted that the stock of asset purchases would reach £645 billion by the beginning of July, at the current pace of purchases. As set out in the minutes of its meeting ending on 25 March, the MPC could expand asset purchases further, if needed to meet its remit.

66 The Committee turned to its immediate policy decision.

67 Consistent with its remit, monetary policy was aimed at supporting businesses and households through the crisis, and limiting any lasting damage to the economy.

68 In the illustrative scenario, the recovery in economic activity was relatively rapid and inflation rose to around the 2% target, conditional on the scenario assumptions that included a gradual easing in social distancing, and supported by the very significant monetary and fiscal stimulus.

69 The MPC judged that there were, on balance, downside risks around the illustrative scenario beyond the very near term. The Committee discussed a number of channels through which downside risks to activity could emerge. Different members placed different weights on particular arguments. All members agreed that monetary policy had a role to play in minimising the persistence of these effects.

70 On balance, the risks were probably skewed towards an even longer period of precautionary behaviour than assumed in the illustrative scenario. Voluntary social distancing might be more material. Workers might be worried about the security of their jobs for a longer period of time. Companies could remain more risk averse and so take longer to re-hire employees and also apply a higher hurdle rate on their future investment decisions. The financial system was, however, in a much better position to support households and businesses through this period compared with the global financial crisis.

71 The extent to which GDP recovered would also be affected by developments in the economy's supply capacity. There could be greater medium-term weakness in productivity than assumed in the illustrative scenario, for example via a misallocation of capital and labour following the pandemic. Associated with that,

there could be a mismatch-induced rise in the long-term equilibrium unemployment rate, as had been seen in the aftermath of previous recessions.

72 There was a range of views among Committee members about the weight to place on the illustrative scenario in forming their policy positions. While it illustrated the important drivers of the outlook, the scenario showed just one of many different ways in which the economy could evolve and so was less informative for the setting of monetary policy than the Committee's usual projections. For some members, that suggested placing more weight on the early part of the scenario.

73 The Committee would learn more about the economic outlook as a plan for starting to relax Covid-related restrictions on activity was announced and as greater evidence emerged, including from other countries that had exited lockdowns earlier, about the extent of voluntary social distancing and its impact on the economy. Many of the medium-term uncertainties that the MPC was considering were likely to remain unresolved for some time, however.

74 The Committee also noted the improvement in market functioning, including in the gilt market, since its mid-March policy actions. There was a range of views about the likelihood of further market dysfunction in the current environment, but all members agreed that the Committee would act rapidly should market conditions similar to those seen in mid-March re-emerge.

75 At this meeting, a majority of MPC members judged that the existing stance of monetary policy was appropriate. The existing programme of asset purchases was not yet complete. More information on a number of important assumptions underpinning the scenario analysis, and so determining the economic outlook, was likely to become available over the coming weeks. There was value in waiting for that information. For all members of this group, the prospective weakness in employment and inflation, and downside risks around aspects of the medium-term outlook, might necessitate further monetary policy action to support the economy in the future.

76 Two members preferred to ease monetary policy by announcing a further increase in the total stock of asset purchases at this meeting. Unemployment and underemployment were rising rapidly, and CPI inflation was set to weaken significantly. Financial conditions remained significantly tighter than at the beginning of the year. It seemed likely that uncertainty and risk premia would remain relatively high for some time. Without further monetary stimulus, there could be greater scarring effects on the economy via both demand and supply channels. These members judged that it would be preferable to announce now that the current pace of asset purchases would be maintained at least until the time of the August *Monetary Policy Report*, in order to limit further tightening in financial conditions and hence to underpin the recovery.

77 The MPC would continue to monitor the situation closely and, consistent with its remit, stood ready to take further action as necessary to support the economy and ensure a sustained return of inflation to the 2% target.

78 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 the programme of £200 billion of UK government bond and sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, to take the total stock of these purchases to £645 billion.

Regarding Bank Rate, the Committee voted unanimously in favour of the proposition.

Regarding the stock of purchased assets, seven members (Andrew Bailey, Ben Broadbent, Jon Cunliffe, Andrew Haldane, Dave Ramsden, Silvana Tenreyro and Gertjan Vlieghe) voted in favour of the proposition. Two members (Jonathan Haskel and Michael Saunders) voted against the proposition, preferring to increase the target for the stock of asset purchases by an additional £100 billion.

79 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, Ron Kalifa was present on 4 May, as an observer for the purpose of exercising oversight functions in his role as a member of the Bank's Court of Directors.