Bank of England

Quarterly Inflation Report - 10th February 2010

Jenny: Could I ask if you have any questions just to say your name and the organisation you represent, please. Joel.

Joel Hills, Sky News: At the Reports, Governor, you talk about the need to significantly address the fiscal position here in the UK. In Greece the government has taken difficult decisions with a view to addressing the budget deficit. Are you happy that in the UK the right decisions are being made politically?

Mervyn King: I don't think you can compare the UK with Greece. There are big differences. We have our own currency; there is a clear political consensus to take action to deal with the fiscal position here. We have a very good track record, and maybe most important of all, the maturity of the government debt in the UK is much longer, so rollover problems of refunding government debt are much smaller.

So I think the problems are very different. In terms of what's needed in the UK, I made my position very clear in evidence to the Treasury Committee in November, and again in a speech in Exeter in January. I've got nothing new to say on that. You can look at the words there, and you'll see the position stated very clearly. There's nothing new to add today.

Paul Wallace, The Economist: Inflation you're now forecasting at around 3.5%, in the beginning of this year, and in November it was more like 3%. And inflation has come in higher than you've been expecting. Why is this? Is this because you've - are you now thinking that maybe less supply capacity has been lost, or is it because of - the same amount of supply capacity that you originally thought had been lost, but it's having less of an effect? Or is it because of greater feed-through from the weaker pound than you had previously expected?

Mervyn King: It's really the shorter-term factors. It's only to do with the beginning of the forecast horizon. And it's two things really. One is higher petrol prices, so there's more inflation that's actually occurred, and that will carry through to the beginning of - through this year, beginning of this year. But the other thing is that our Agents, when talking to business contacts around the country have come to the judgement, which the Committee has incorporated into its forecast, that somewhat more of the increase in VAT back up to 17.5% will be passed through in prices at the beginning of this year than we had previously assumed. So those are the factors which push up the short-term forecast.

Then looking further ahead, the position is really pretty much unchanged from November, which is that for much of the forecast inflation comes back to below the target because of the impact of a very large amount of spare capacity; returns to target at the end of the forecast horizon, with the risks pretty broadly balanced around that, around the target at the end of the horizon.

Paul Wallace, The Economist: And as a follow up from that, so you haven't changed your estimates of how much spare capacity there is ?

Mervyn King: No, I think if anything we're more uncertain about how much spare capacity there is. It's an extraordinarily difficult judgement to make, and I think the Committee - we had a long discussion of this - we were more inclined to think that this is a reduction in effective supply in the short run that could be reversed. So I don't think we are confident that this reduction in supply capacity will necessarily persist. And indeed we are in a position where, if growth in demand were to be rapid, I suspect that much of the capacity which has been, quote, “lost”, would come back and be able to be used again, whether in the labour market or on capital stock.

On the other hand, if growth in demand is weak and persists, then much of that lost capacity may turn out then to be a more permanent loss of capacity. So in that sense I don't think it's easy to make a judgement about how much has been lost. How much will prove to have been lost will depend very much on the path of demand over the next couple of years. It's endogenous to the path of the economy over the next couple of years.

And that makes it much more difficult, I think, to form judgements about supply capacity, though it does suggest that, if demand is particularly rapid, then it may not be the case that inflation would pick up quickly, because the supply capacity will come back on stream. It also suggests that, if demand was particularly weak, then maybe inflation would not fall necessarily so far below target as one might fear, because the supply capacity would be contracting at the same time.

Stephanie Flanders, BBC: Just on this question of fiscal policy, both David Cameron and George Osborne have said that they would be setting a Conservative’s post-election budget policy in co-ordination with the Bank of England, and would co-operate with you about the scale of any tightening after they won the election, if they won the election. Could you just say something about how that would work and how that would be consistent with the Bank of England's independence?

Mervyn King: I think you'll have to put the question to them. I mean, it's not for me -

Stephanie Flanders, BBC: Well, they're suggesting that you would co-operate, that you would co-ordinate -

Mervyn King: Well, I'm sure that, whichever government is elected at the general election, we would co-operate with it. We've always done that in the past; we will in the future. I don't know what this means. I think what has worked so far, and works extremely well, is that we know exactly what the fiscal position is, we get confidential briefings from the Treasury about the stance of fiscal policy, both about revenues as they emerge over time, and about what their plans are that will be announced in future statements or budgets. The Treasury have always been very clear in giving us that information.

And in the light of that, then we can set monetary policy along with all the other factors that influence monetary policy. So fiscal policy is an input into monetary policy; it's obviously not the only one. And when we judge the outlook for inflation, then we know what the fiscal stance is and we can take that into account and set policy in order to meet the inflation target.

The key thing really is that monetary policy is something that can be changed every month, whereas fiscal policy is not. And in that sense monetary policy clearly has to bear the burden of steering the economy, and that's I think the position that everyone since '97 has agreed with. And that's the position that we would adopt.

Stephanie Flanders, BBC: Just to follow up a little bit. I mean, what you've described is a one-way street in terms of the Treasury informing you, and then the Bank of England goes on. The suggestion here is that it would be a two-way street because things that the Bank of England indicated to them would set their fiscal parameters. Is that not the case?

Mervyn King: Well, I can't comment on that because I don't know what this proposal means. You've put your words to me; all I can say is how the MPC operates now.

Sean O'Grady, The Independent: On page 15 of the Report you say - The major UK banks have a significant amount of funding maturing over the next few years. And we heard what the Council of Mortgage Lenders said about that last week. Are there any circumstances in which you would consider extending or replacing the Special Liquidity Scheme, when those funds become due? And if not, where do you suggest the banks find their funding over the next few years?

Mervyn King: Well, we certainly have absolutely no intention at all of extending it. This is the most generous scheme that's been put in place in the world. Banks in this country have been given three years' funding for the securities they lodge with us. There's no other country in the world that's got a scheme that lasts as long as that, and that's more than enough.

We are working with the FSA and the individual banks to ensure that they have schedules of refunding this money, so that we don't simply have a very large amount to be refunded at one moment at the end of the scheme. And that's very clear.

But I think the position has changed a lot since this scheme was introduced. Over the past year many banks have actually issued quite a lot of both equity and debt, and they have been able to obtain funding in the market. What is most important now is that banks go out and do that; that they raise capital in order to restore their balance sheets, and that can be done by, not just issuing new capital, but actually ploughing back retained earnings rather than distributing it as bonuses or compensation. That should be ploughed back to boost the balance sheet.

And they should be willing to issue longer-term debt securities rather than rely just on very short-term instruments. That of course will mean that in future banking will be less profitable, but that I think is an inevitable part of adjustment to the consequences of this crisis. And we will be working with FSA to ensure that banks do put in place a proper profile for raising the required funding.

It's very important not to penalise those banks that have gone out and raised extra capital and debt funding. Many banks have done that; they should be lauded for that, and they should not be penalised because they've gone out and raised more expensive funding now rather than just hanging on, waiting for a handout. The SLS will not be extended.

Chris Giles, Financial Times: Governor, politicians might be forgiven for being slightly confused exactly how the Bank views fiscal policy and the fiscal/monetary mix. In 2002 you talked about balanced budget multipliers; less than two years ago you talked about Ricardian equivalence as the way to think about how fiscal policy affects the economy. Today you talk in a very Keynesian way that the consolidation is likely to put downward pressure on spending and inflation over the forecast period.

Just so politicians and everyone can be clear, can you explain how you think fiscal policy affects the economy, and how monetary policy can or can't offset it at the moment?

Mervyn King: Well, it depends on the nature of the fiscal changes that are made, and changes in spending are different from changes in taxes. And unexpected changes are different from expected changes. I think one of the questions which arises to which it's not easy to come up with an answer; but I - everyone has been surprised by the scale of the increase in the deficit and the structural deficit. I don't think before the financial crisis that people would have said that that was where the structural deficit was. So this has been a very important piece of news that will have affected private spending in the economy. And it's not easy to judge when the measures to deal with the fiscal deficit are taken, how far they will be a surprise or how far they're already captured in spending by households.

And of course much of that will depend upon whether the action taken is on spending or on taxes. So I think you've got to be more specific in your question. I don't think there's anything inconsistent here with thinking that part of the response of households is Ricardian in the sense that if they anticipate significant tax increases, that will be reflected in spending today. But none of us know whether the reduction in deficit will come or how much of that reduction will come in higher taxes, as opposed to lower spending. So there's got to be a lot of uncertainty about that, and that in turn may be impact on spending.

So, you know, I don't think there's any inconsistency between the way we think about it. The way we think about the interaction between monetary and fiscal policy was the answer I gave to Stephanie, that on the MPC we're very clear what the stance on fiscal policy is, insofar as it has been made clear. We have information on what the government's plans are, and we can take that into account when setting interest rates month by month.

I don't think it's sensible to regard fiscal policy as something which is fine-tuning. But the scale of the deficit now has got nothing whatsoever to do with fine-tuning the economy; it's a very large structural deficit which needs to be eliminated.

Chris Giles, Financial Times: Can I just ask a quick follow-up? Governor, the President of the European Central Bank is very clear on this. He thinks that consolidating budgets improve confidence, and therefore is stimulative. Do you disagree with that view?

Mervyn King: I think it depends on the circumstances. You need to be able to have a package of policy measures - and in our case we can allow monetary policy to respond to measures that are taken to consolidate the budget. But, you know, there are questions about timing - how sensible it is to do something overnight - and to make sure that it's carefully planned. So I don't think this is something you can just treat as an academic exercise where you've got something called G for spending and T for taxes, and you know, do you move them immediately or not? Spending is all about planning, you know, big programmes for different government departments. That means you have to think through the real consequences of making those changes, and thinking about the optimal timing of making those changes. And ditto for changing the tax system.

So I just think it's more complicated than just saying, you know, you must always close the deficit immediately. But what is very important, and why I totally agree with Jean-Claude Trichet, is that at all times governments need to have a clear and credible plan for reducing a structural deficit. I've said that before; there's nothing new in that. But I think that's something which - I don't know anyone who actually disagrees with that proposition.

Svenja O’Donnell, Bloomberg: Governor, Tim Geithner says the US will never lose its AAA rating. Can you say the same for the UK?

Mervyn King: Well, no one would ever say - never say never is a dangerous thing to say, but I cannot think of any reason why the UK should lose it. And it would be most peculiar if this were to happen.

We now await announcements by government, before the election and perhaps after the election, about the precise measures that will be implemented to bring down the deficit. But as I said, the UK has a very good track record over a long time. There is a wide political consensus in the UK, right across parties, on the need to reduce the deficit. We have a much longer maturity structure of our debt than almost any other country - much longer than the United States. That reduces the rollover risk facing refinancing of the debt.

We're in a strong position, and it's ours to lose. All we have to do is to behave sensibly, and I'm sure we will. And I think the rating agencies, if they have any sense, will see that.

Sam Fleming, Daily Mail: In your opening comments you seemed to be taking some comfort from the revival we've seen in asset prices, equities and property. There's obviously some concern that asset prices are beginning to become detached from fundamentals again, given the underlying weaknesses in the global economy. Do you share any of those concerns, and were those concerns relevant in the decision to suspend quantitative easing?

Mervyn King: No, I don't think they were. The consideration that was relevant - I mean, let's go back to where we were when we started the asset purchase programme. As I said, output was falling very rapidly; confidence had collapsed. There were real concerns that we might be in for a repetition of the 1930s. And asset prices factored that into account, so they had fallen very sharply from their peaks the previous year.

Any policy introduced last spring to deal with that crisis, that was going to be successful, would inevitably lead to a rise in asset prices; so this is a sign of success. We have managed to reduce, I think, significantly, as in our forecast, people's beliefs about the risk that we would see a repetition of the 1930s. I think people feel that we've stopped that from happening.

Now we're still a long way from seeing recovery, but we've stopped a repetition of continuing falls in output. That in and of itself would have led to rises in asset prices, and we saw that in the equity market in particular. So I think that was something which was bound to be a by-product of a successful policy. So in that sense, it's encouraging that we have seen it, and I think that was bound to be the case.

Faisal Islam, Channel 4 News: Governor, is this GDP forecast consistent with a quarter or two of further negative growth this year? And if that's the case, and given the sluggish number in Q4, does that say anything about the speed or timing of the fiscal adjustment - that it might be sensible to slow it down a little?

Mervyn King: No, I'm not going to comment any further on fiscal policy. Of course this forecast is consistent with a possibility of another quarter of negative growth, just as it's consistent with several quarters of very rapid growth. This is not a point forecast; we present it as a Fan Chart. If you'd look at the Fan Chart, you'll see that many things are possible.

I think it's just very, very important - particularly in this situation - for you to explain to your viewers and your readers that forecasts are not numbers which say this will happen. They are judgements about the relative probabilities of various outcomes occurring. And of course there is always a possibility of these outturns. Many things can happen. The world economy could turn down again. Who knows? We cannot be entirely confident of this. It may grow very rapidly again. These are things we cannot know in advance. What we have to do is to be prepared to change policy as, and when, appropriate, and we will do that.

I think you'll see in the Fan Chart that these outturns are there. Our central view is for a gradual recovery. But around that there are many risks, and there's no point in pretending that we can see the future when we can't. What we have to do is to be prepared to respond to events that mean that the recovery is, or is not, moving in the way that we had expected.

David Smith, Sunday Times: Governor, you're projecting - your central projection is for quite an aggressive fall in inflation for the remainder of this year and into 2011. I wonder if you're concerned at all that the trade-off between growth and inflation has worsened, because the Bank's projections during 2009 were consistently lower than the outturn, despite the fact it was a very serious recession - sharpest fall in GDP for a very long time.

Mervyn King: Well, I'm not sure if I am terribly enthusiastic about thinking of a structural relationship in that short term trade-off. The nature of the short-term trade-off must reflect the nature of the shocks hitting the economy. And the particular shocks, whether it's changes in VAT or petrol prices, will have a very different impact than if it's a much weaker level of demand or a much stronger level of demand. And I think you can't therefore think about a structural trade-off independently of identifying the nature of the shocks.

I think in terms of what we've seen in the past sort of year, I think we feel that the pass-through from the fall in sterling perhaps has taken a little bit longer than we thought a year ago. I don't think it's a major change there, but I think there's, you know, perhaps some change.

The biggest changes though have been short run movements and energy price changes that - we had expected energy prices to fall and they've - oil prices have risen by two thirds over the last year. That's had quite a significant impact on our judgement about the path of domestic gas and electricity prices. And that's been the major impact in terms of short-run movements in inflation.

In the long run picture we still stick to the view that it's very hard to know how much spare capacity there is, but there does seem to be quite a lot, and this will continue to bear down on inflation. I don't know that the movements are particularly dramatic compared with what we've seen in the past. We've seen very sharp rises and falls in inflation - remember it's not long ago since inflation was over 5%. Then it came right back down to 1.1. So there clearly can be significant volatility. The hard part is to judge the medium term outlook.

Ed Conway, Daily Telegraph: It's another Greece question I'm afraid. But this time around although …

Mervyn King: You don't have to ask it if you don't want to, you know.

Laughter

Ed Conway, Daily Telegraph: I feel duty bound I'm afraid. It's possible to characterise, well it's important to characterise the Greece issue as a fiscal issue; but by the same token it has been characterised by some as a euro problem. And you mentioned one of the reasons that the UK is able to – well, is in a different position, is because it has its own currency. To what extent is the crisis in Greece a kind of vindication of Gordon Brown's decision not to take us into the euro all those years ago?

Mervyn King: I think that's what is known technically as a loaded question. There are times and places for a lecture on the theory of monetary union, but I don't think this is one of them. At the weekend our euro area colleagues made very clear that they saw this as an issue which they would deal with in the euro area and I think they should be allowed to do it. So I think you should put those questions to the representatives of the euro area later this week, I don't think it should be for me to comment.

Ed Conway, Daily Telegraph: That was your first explanation as to why we're in a different place, and clearly that's the opportunity to adjust through some depreciation or otherwise. Isn't an opportunity available to Greece or to Spain?

Mervyn King: That is indeed a true statement of the position, as a fact.

Heather Stewart, The Guardian: You've talked quite a lot in the past about a hope for rebalancing of the UK economy away from domestic consumption towards exporting sectors. How important is that likely to be in getting levels of GDP back to that long term path that you've talked about and is it something you see any signs of yet, or that we shouldn’t hope for until there's a stronger recovery in the global economy do you think?

Mervyn King: I'll ask Charlie to comment in a minute. I'll just say one thing that we discussed at the weekend. Clearly we do need a rebalancing in the UK economy and I think every country that experienced a large increase in debt, and was running a large trade deficit before the crisis hit, is going to see a rebalancing; that's part of the long term restructuring that's required. And we from that point of view we need an increase in net exports, and the fall in sterling that we've seen since the beginning of 2007 is part of that adjustment process.

Now, we have not yet, it's fair to say, seen in the data very much evidence of an encouraging pick-up in net exports. I think it's still relatively early days in this process. Remember it's only a year ago since we started our Asset Purchase Programme. The lags in monetary policy in normal times we think of as long and variable and taking up to two years. So perhaps - I know the last year has seemed like an eternity, but it isn't in terms of the length of time for which these things have been operating and the lags may take longer.

And there is a concern that in the world economy, you know, we will want to see a recovery and pick up in the world economy. But we're still in a difficult position facing the world economy. I don't think we're out of the woods by any means. And at the weekend it was quite clear that among the G7 several major economies were saying - well we are relying on a recovery in the global economy to boost our demand.

Well since, taken together, we were a large part of the global economy, it wasn't entirely comforting. So I think there's still some way to go, but Charlie also took place in the discussions.

Charlie Bean: Okay, I mean the first thing I think it is worth saying is that the downturn that we've gone through is heavily manufacturing-centred, a sharp fall in investment and stocks. And the UK obviously is somewhat less manufacturing intensive than some of our counterparts. That's meant that we didn't suffer as sharp a contraction in activity as, say, Japan did, but equally the rebound hasn't been quite as strong.

But, broadly speaking, I think it's fair to say that the behaviour of both imports and exports over the past year or two has been tracking activity levels; so imports moving in line with an appropriately import-intensive weighted measure of domestic demand, and exports tracking UK weighted export demands or the level of world trade.

What we expect to see, but as the Governor has already hinted we haven't really yet seen coming through, but I think we're pretty confident we will see in due course, is an effect on both the share of exports in world trade and also on imports from the substantial depreciation of sterling, which is down about a quarter from its pre-crisis levels.

So far most of the depreciation has gone through, if you're looking at exports, into higher profit margins. Some people think, “oh well that means we won't get any benefit”, but of course higher profit margins encourage exporters to increase their supply, expand into export markets where they're not already present and so forth. And that takes time, and if you look at the history of past large depreciations; if you go back and look at what happened after the 1992 exit from the exchange rate mechanism, it took time for the beneficial effects on net trade to come through.

So we expect to see that over the course of the next couple of years, but it will take time.

Yvonne Esterhazy, German Business Weekly, Wirtschaftswoche: You've just said it's very important that governments always have a clear and credible plan to reduce the deficit. I was just wondering how worried you were about the possibility of a hung parliament in this country, and also what would it do to sterling?

Mervyn King: That's a question about politics, but I don't think it's something which has concerned the Monetary Policy Committee, as I said earlier. I think there's a broad consensus across all political parties on the need later this year to announce more clearly the measures required for fiscal consolidation. So I don't think it's something that concerns the MPC.

Laurence Norman, Dow Jones: A couple of questions if I may? First of all, in the November Inflation Report Treasury Committee you gave an estimate to them of what you believed the forecasts for 2010/11 were, taking into account the range of risks, and it was different from the forecast that came out of the Fan Chart. I'm wondering if you could give us an equivalent this time round?

And secondly Joe Stiglitz was in town yesterday and he was saying that one of the enduring lessons from this crisis is that countries that had large reserves have actually done better; they had a protection there. Are you concerned that that could make the global imbalances situation not just no better, but significantly worse, in the future?

Mervyn King: Well I'll take that second question and perhaps ask Spencer to take the first one; we may have to get some clarification of what the question meant. But on the second one, I don't think that anyone has enjoyed this crisis or come out of it particularly well. And I think the falls in output of many of the countries that had large surpluses and had been building up foreign exchange reserves were at least as large, if not larger, than the falls in output of the countries which were formally the deficit countries.

So one of the lessons we should learn is not so much that going your own way to build up reserves give you protection against a crisis of this kind, because it doesn't. When you see a large financial crisis hitting the world with a crisis of confidence that spread across the world so quickly everyone was affected. It is therefore in everyone's interest to try and find a better way of resolve these crises. And that's why in my speech in Exeter in January I talked at some length about the need to find a way through the problem of ever-rising stocks of foreign assets, claims by one country held in another, which in the end will topple over and provoke a financial crisis. And it is about reform of the international monetary and financial system. And Joe Stiglitz has certainly talked about the need for that, and I think he's right to talk about the need for it.

But I don't think you deal with that problem by building up your own reserves. That was a lesson that came out of the Asian financial crisis in the 1990s, and was a very clear lesson that if you have a banking sector that has a very large currency mismatch then, as a government, unless you can be a lender of last resort in foreign currency, then you do not want your banking system to have a currency mismatch. And that was classically the case which Korea found itself in and where the international community then lent money to Korea, so that it could in turn lend it on to its own banks.

Now the lesson drawn from that by many countries, particularly in Asia, was to build up very large foreign exchange reserves. That was not the only reason behind the wish to have a large trade surplus; the wish to have an export growth strategy based on manufactured exports to the rest of the world was also another very important and perhaps even more important reason.

But I don't think from this crisis you draw the lesson that having a large stock of foreign exchange reserves protected you from the crisis, because it didn’t. The downturn in output around the world was simultaneous and very similar and very large, everyone suffered. And that's why it's very important to get to the root causes of this crisis and try to make sure that it isn't repeated in future.

Male: The first part of the question?

Mervyn King: Oh yes, the first part of the question?

Spencer Dale: I was sitting here hoping that you weren't going to pass it to me, as I didn't quite understand the question, so could you clarify it?

Laurence Norman, Dow Jones: I think it was the Governor in the Treasury Select Committee Hearing said that taking into account the range of risks included in the projections, the MPC expected the economy to grow 1.5% in 2010 and 3% in 2011. Those numbers were lower than what came through from the Fan Chart in the Inflation Report, so I'm wondering if we could get an equivalent?

Spencer Dale: I'm not exactly sure of those numbers. I think an issue which the Governor has already talked about today is when we're thinking about the projection, the Committee is very clear in its own mind that it thinks about the whole of the distribution and not just a single point estimate. And some frustration to us is that, when you report it you then - often people just report the single model projection and ignore all the risks around it. And when trying to convey our sense about the GDP forecast that's not a good an accurate representation.

So my guess was the numbers the Governor may have been referring to may have been looking at a different measure of central tendency of this projection, when you can look at the means of the projection or so on. So I'd imagine - but the general, the big picture point is don't try and summarise our projection in a single point because that won't accurately convey the message that we think is important, and is the one we take into account when setting policy.

Alan Mattich, Dow Jones: Could I refer you to chart two; it's always puzzled me a little bit. It is reasonable to base a policy on pre-crisis trends when that trend was built on the biggest accumulation of private sector debt, I think McKinsey shows, of any developed country more or less ever?

Mervyn King: I think it's perfectly reasonable because if you look at what happened to the growth rate of output in the economy, it followed its long run historical trend all the way through. At no point could you argue that the growth rate of output or the amount of spare capacity was unsustainable. And that was true of many economies around the world. What happened was that most of the increase in debt was taken up within the financial sector. Two thirds of the increase in debt extended by the UK banking sector in the five years running up to the crisis was actually extended to the financial sector, not to the non-financial sector.

So I see no reason to suppose that, had there not been a crisis, that the underlying growth rate of labour supply and productivity growth would have been any different. And that's the basis for making that statement.

Alan Mattich, Dow Jones: That McKinsey report also shows that the weight of debt is enormous and economists like Ken Rogoff have suggest that central banks need to run inflation at upwards of 6 or 7% in order to alleviate that burden.

Mervyn King: Well time will tell; I see no particular reason for doing that and I think it's perfectly feasible to have an adjustment over time in which households and companies can adjust their debt if they wish to do so. But as I said, the real debt problem in the UK - this is the most important point - the real debt problem in the UK was within the banking sector and the financial sector more generally. And that's the amount of debt that needs to adjust. It is adjusting very rapidly as banks are contracting their balance sheets, and that's one reason why the supply of credit has been reduced. And I don't see any way in which inflation would help the banking sector in that sense.

So I think the adjustment of the size and leverage of the banking sector's balance sheet was the really important issue that we've got to deal with in terms of the adjustment, and it's already well underway. It will take time, but it's well underway.

Dan Atkinson, Mail on Sunday: Governor, on page 12 you have a look at the gilt market, and your staff have been talking to gilt market participants and so forth and you've been looking at the way the gilt market is behaving. Is it far to say that these participants are basing their assumptions and their actions on the notion that the return into private hands of the enormous numbers of gilts that you've bought under the Asset Purchase Programme is so far away in the future as not to be a concern to them? And if the answer to that is yes, are they right to make that assumption?

Mervyn King: Well let me ask Paul to comment on the information that we've gleaned from our conversations with market participants. Paul.

Paul Fisher: I think the - and we've said repeatedly that at some point in the future we'll be looking to return the gilts we hold into private sector hands. The market is well aware of that. So I don't know quite where your presumption has come from?

Dan Atkinson, Mail on Sunday: No, sorry it wasn't a presumption from the facts in the Inflation Report it was simply - is the sense that you are getting from the market participants that the date of that return, which obviously will happen one day, is so far in the future that from the point of view of a market trader or a market participant, it really isn't worth worrying about. And if that is the assumption they're making are they correct to do so?

Paul Fisher: No and in fact they're very interested in, and continually asking us for information, which we can't give on exactly when that return might commence. So I don't they see it as being in the indefinite future. But I can't tell you today how long it will be.

Mervyn King: They used to ask us all the time about when interest rates would go up and down, now they ask us all the time about when we will consider selling the assets. They would love to know, but we make our judgements one month at a time.

Stephanie Flanders, BBC: Just looking at the GDP projection and actually particularly back-casts, the estimates of past growth. There seems to be that you were assigning a very strong probability with your full range of relative probabilities - it looks to me that over 60% - that recent growth estimates reported by the ONS will be increased quite significantly. Can you just talk a little bit about what you're basing that on? I'm particularly interested on whether you're basing it on the past history of revisions or independent evidence such as survey evidence of what's actually going on in the economy?

Mervyn King: I'll ask Spencer to comment on this in a second. I mean, it is certainly based on past revisions. But you know data are always revised, the important thing about the back-cast is just to make clear that the data published are not - you know the truth, they are estimates. They are single best estimate we've got from the ONS of GDP, but inevitably new information comes along with a lag and that leads them to revise their data.

Stephanie Flanders, BBC: But you were expecting there to be a strong bias in the revision, so it's not just random quarters?

Mervyn King: On average data have been revised up, not by a lot, but have been revised up. But I don't think that's the big picture, you know. The big picture really is chart 2 which is that whether output in Q3 was - or Q4 was plus 0.1 or minus 0.1 is frankly neither here nor there. Output has fallen by 6% since the crisis began; that's a massive fall in output. And a 0.1 or 0.2 is not going to make any difference to that big picture. It's going to take a long time for that to be earned back in terms of future growth.

So that's the big picture that's what we want to focus on. But perhaps Spencer could comment on the nature of the assumptions that go into the back-cast in that chart?

Spencer Dale: And certainly - and that same big picture is also shown if you just focus on the back-cast which is on chart 3.2 on page 25. When we're producing the back-casts we take account - our primary source of information is the ONS data. In addition to that we look at past revisions in the ONS data, and we also take into account a range of other indicators; business surveys, our reading of what's going on in different parts of the economy, the labour market and so on, the information we're gleaning from the agents and we put all that together. And as the chart 3.2 makes clear and as the Governor says, the big picture is very similar to the ONS's headline numbers which are we've seen a very substantial fall in the level of output over the past year or so.

There is incredible uncertainty; significant uncertainty surrounding the precise extent of that fall and our judgement is it's more likely than not that that level of output will be revised up. But even so, you'd still be left with a very substantial fall.

It's perhaps worth noting that the extent of that revision we have revised up a little bit over the course of the last three months. Part of that reflects just further analysis within the Bank concerning - thinking about the information we can glean from other information like business surveys as well as the ONS data.

Part of it also reflects new information published by the ONS which now shows a greater discrepancy between data they publish - their estimates of output based on - or their estimates of GDP based on output data and their estimates of GDP based on expenditure data. The headline numbers that the ONS currently publish place most weight on the output data. In our back-cast we also place some weight on the expenditure data, and that accounts for some of this slightly bigger upward vision we expect to see.

William Keegan,
The Observer: Mr Governor, given the point you made to G7, everybody else seemed to be waiting for an increase in world demand, was there any sense that the policy makers are concerned that there is a hyena-like call for instant deficit reduction everywhere, and that this is actually hampering the kind of revival of world demand that everybody wants?

Mervyn King: I don’t recall anyone mentioning hyenas. There were other animals around, but I don’t think there were any hyenas in Iqaluit. And I don’t think that was something that really came up in the conversations.

All I would say is that it was a very successful meeting in the sense that because there was no communiqué, there were private conversations and they were much more productive than usual. So it was a success, even if there were no hyenas.

Chris Giles, Financial Times: Looking at the overall balance of the forecasts, which you can summarise on page 40 on charts 5.4 and 5.5, relative to November's forecasts the overall profile of the inflation outlook is lower but the conditioning assumption is also lower so it's more stimulative. What's the reason why you both think inflation in the medium is going to be weaker, yet you've got more of a monetary policy push behind that?

Mervyn King: I'll leave Charlie to explain 5.4 and 5.5.

Charlie Bean: Yeah, I think a key point to draw to your attention is that, as Spencer noted earlier, it's not just central projections, it's the whole distribution that matter.

Male: The whole distribution …

Charlie Bean: What we have done in the projection, we've taken into the modal path if you like some of the downside risks that we saw earlier on. So the growth projection - just to go back to that for a minute - the modal projection there is somewhat lower but there's less downside risk. And roughly speaking the average across the whole of the distribution it's about the same as we had in November.

Corresponding to that, in the inflation projection, because the central projection for growth is lower, you will expect the outlook for inflation to be somewhat weaker. And that is exactly what you have in the central projection. But, as compared to November where the risks were balanced around the central projection, we now have upside risks.

So relative to the target, not the central projection, the risks are roughly balanced at the three-year horizon. So the movements in the central projection inflation are a reflection to a large degree of what's happened to the growth projection. But the big picture here is that, if you like, the average picture across growth - across the whole of the distribution - is about the same now as it was in November and that's equally true for the inflation projection. The inflation projection is notably stronger in the near-term and that reflects the factors that the Governor was talking about earlier, developments in petrol prices, expectation of higher VAT pass-through and so forth.

Chris Giles, Financial Times: You haven't mentioned anything about your conditioning assumption, which is quite a lot different to November, so does that mean that has very little effect on your projection?

Charlie Bean: I mean - it has some effect but I mean, we've also made obviously various other changes in the forecast, slightly tweaking estimates of the margin of spare capacity, of how quickly quantitative easing is passing through, all those sorts of things. But they're detail. I mean the big picture; the big message that you should take away from this forecast is that our view of the average outlook going forward is pretty much where we were in November.

Anna Edwards, CNBC: I'm sorry to fixate with my ruler on your charts but - can I understand then - two questions? Firstly you do not want us to take away from today that you are slightly gloomier now than you were in November about growth forecasts for 2010, because it does look as if the central projection has moved a little bit lower from those charts, even though you say it's broadly similar. And - because I guess I know the answer to that one.

And secondly, quantitative easing, you say that the door has been left open. What will make you open that door again?

Mervyn King: Well the answer as you correctly guessed to the first is no. And to the second it's a judgement about the outlook for inflation. The Committee will - it seemed very natural at this juncture after such a large policy stimulus and such a large shock, not just to the UK economy but to the world economy: we're not in the business of fine-tuning here. This was a good time to take stock and see what will happen. But all our decisions will be based as always on a judgement about the outlook for inflation.

Claire Jones,
Central Banking Publications: Jean-Claude Trichet said yesterday that other central banks should follow the European Central Bank's lead in paying more attention to money and credit developments when making monetary policy decisions. I just wondered if it would be possible to get your take on this view?

Mervyn King: Well I think we have said right through this crisis that a very important aspect of judging policy is to look at developments, particularly in money, credit too in terms of judging the impact on spending, but particularly money. And that's exactly what our asset purchases have been designed to achieve. So I think actually, more than any other central bank we have been focusing on the need to inject money into the economy. And I think if you look at the comparisons with other central banks they have a slightly more worrying picture about the growth of the monetary aggregates than we do.

Claire Jones,
Central Banking Publications: Can you follow up on that more broadly. Within the central banking community do you think it was something that was perhaps neglected pre crisis by the business press?

Mervyn King: Well it may well have been. I think one of the things that was important was not so much that looking at money would have helped better judge inflation, because I think the ECB itself went to some length to explain why quite rapid growth in money in the euro area was not likely to impact on inflation but would show itself up in a change in velocity.

But I think what everyone paid too little attention to was that this expansion in money was showing up in a rapid growth of the balance sheets of the financial sector. And that aspect of policy, which if you like lay between monetary policy on the one hand and micro prudential supervision on the other, was the bit that was ignored.

Faisal Islam, Channel 4 News: You mentioned before very clearly that the Special Liquidity Scheme wouldn't be extended. And on page 15 there's a reference that seems to kind of back what the banks have been saying, that the cost and availability of funds to replace maturing liabilities will be an important influence on banks' lending capacity.

If you put that together with what you said about, you know, the asset purchases were meant to increase asset prices, is there a suggestion that a year or two down the track Britain's borrowers should expect that asset prices should fall back. That what we've had over the past year has been a kind of conjured, fake growth in asset prices - a bubble if you like - and they shouldn't assume we're back to the 2005 / 2006 days?

Mervyn King: Well no one can forecast asset prices so I don't think you could predict that asset prices will definitely fall back. I mean there's no way you can make that kind of prediction. What we said here about banks' balance sheets is that over the next three years, and the SLS was designed to give a three-year window, longer than any other country has given to its banking sector to reorganise and restructure its funding, then there is clearly a challenge facing our banking sector.

But the banks are very conscious of that. Many of them have already gone out and started to raise capital and funding at - equity capital and longer term debt funding. There is still a long way to go but there is you know a long time to go before the facility comes to an end and the Credit Guarantee Scheme comes to an end.

So you know this has been of enormous benefit to the banking sector but it can’t go on forever. And the schemes will come to an end and the banking sector has a long time now to adjust its structure of its funding. That is part of the adjustment of its balance sheet to the new world, and it will have to do that. But I don’t see why that should in and of itself lead to changes in asset prices because we all know this problem is there; that's already reflected into current asset prices.

Faisal Islam, Channel 4 News: On page 24 there's a reference to why sterling’s depreciation hasn’t passed through into export so strongly. You refer to this rebalancing and the need for sort of specific policies. Do you think that this is a - the rebalancing will happen kind of naturally or will governments have to decide to invest in manufacturing skills and infrastructure and things like that for this great rebalancing in Britain to happen?

Mervyn King: Well I think the rebalancing is all about a shift in demand and that will follow changes in relative prices. That’s why the world we’re in is one in which changes in real exchange rates are very important. That's not just true for the UK; it’s true for the world economy as a whole. And we’ve got to allow that flexibility in order that demand will then follow changes in relative prices.

David Smith, Sunday Times: You said to Dan Atkinson that you wouldn't say when you were going to sell the assets back. But can you give us an idea of the way the MPC thinks about the sequence? The forecasts are based on the assumption that interest rates rise while the £200 billion remains in place. Is that the way the MPC thinks about the sequence of an exit strategy?

Mervyn King: No it's just an arbitrary conditioning assumption. We can observe in the market the market expectation for the future path of Bank Rate; so we can observe that. We actually can't observe a market path for the profile of asset sales or purchases. So we've just taken the arbitrary assumption that it's fixed, and we've done that because part of the purpose of this is that you can see the forecast based on that assumption; you can see the forecast based on constant interest rates; you can get some picture of the forecast from different angles as it were to form a judgement as to what we think.

The exit strategy is very simple. The strategy is to meet the inflation target. That's the objective that will drive the decisions. The instruments are very simple, it's Bank Rate, it's asset sales, if we need to mop up liquidity in the short run then we can do it by issuing Bank Bills. These are all tried and tested instruments, we've used them. There's nothing new here. The US faces slightly different problems in trying to devise new instruments. We don't need to do that. So the instruments are very clear.

The big judgement and question is on timing. And just as with monetary policy when setting interest rates, you can't judge now where you're going to be in six months or a year's time. All you can set out are the criteria that will guide that decision, and we've done that. The criteria that will guide the decision will be the inflation target - nothing else. And we will choose a combination of increases in Bank Rate and asset sales, as the Committee feels is appropriate but in order to hit that target. And you'll see the reaction function over time.

Jenny: That's all we've got time for. Thank you all very much for coming.

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