

INFLATION REPORT PRESS CONFERENCE

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Opening Remarks by the Governor

Output grew strongly in the third quarter. Welcome as that is, it is not a reliable guide to the future. Just as growth in Q2 was depressed by one-off factors and gave a misleadingly weak picture of the economy, so growth in Q3 has been boosted by one-off factors and gives an overly optimistic impression of the underlying trend. Continuing the recent zig-zag pattern, output growth is likely to fall back sharply in Q4 as the boost from the Olympics in the summer is reversed – indeed output may shrink a little this quarter. It is difficult to discern the underlying picture. It is probably neither as good as the zigs suggest nor as bad as the zags imply.

Despite a resilient labour market – as we saw again in today’s figures – the economy has barely grown over the past two years. That unexpected weakness reflects the impact of the euro area crisis and its effect on confidence and bank funding costs, and the sharp squeeze on real incomes from higher than expected world energy and food prices. As some of these headwinds abate – as they look set to do – a slow recovery is in prospect, supported by a fall in bank funding costs brought about in part by the Funding for Lending Scheme.

The Committee’s overall judgement about the outlook for four-quarter GDP growth is summarised in Chart 1 on page 6 of the *Report*. As usual, it is based on the assumptions that Bank Rate follows a path implied by market interest rates, and that the size of the Bank’s asset purchase programme remains at £375 billion. In the near term, growth is sluggish. Further out it is likely to pick up gently as households’ purchasing power begins to strengthen and credit conditions ease. But GDP growth is more likely to be below than above its historical average rate over the entire forecast period. The subdued recovery reflects a judgement that the global environment will remain unfavourable. In addition, the Committee believes that the effective supply capacity of the economy is likely to continue to grow slowly over the forecast period.

In October, CPI inflation picked up to 2.7%, partly as a result of higher university tuition fees. The Committee’s best collective judgement of the outlook for CPI inflation is summarised in

Chart 3, on page 8 of the *Report*. It is based on the same assumptions about monetary policy as Chart 1. Inflation is likely to remain above target for the first part of the forecast period, and is higher than in August, reflecting recent outturns and the announcement of large increases in household energy prices. Further declines in inflation are being checked by price increases in sectors where market influences are weak – the rise in student tuition fees alone added over 0.3 percentage points to yesterday’s inflation figure, and domestic gas and electricity prices are rising faster than wholesale energy prices. Such factors are pushing up inflation by over 1 percentage point a year, and the rate of inflation in those sectors influenced more by market pressures would have to be unusually low for inflation overall to be close to the 2% target. Nevertheless, the Committee judges that inflation is likely to fall back in the second half of next year, as the impact of short-term pressures wears off and slack bears down on pay growth. Towards the second half of the forecast period, the risks to inflation are broadly balanced around the target.

We face the rather unappealing combination of a subdued recovery with inflation remaining above target for a while. An unfavourable external environment continues to shape our prospects. The international imbalances which played such a pivotal role in the run-up to the crisis still remain. The pattern of surplus countries reluctant to expand domestic demand to protect their trade position and deficit countries restraining domestic spending to reduce their debt ratios is only too familiar. It is a recipe for weak global growth.

For a country like the United Kingdom attempting to rebalance her economy such an outlook poses real challenges. If that unfavourable world environment persists – and there is little sign of any change to the underlying problems in the euro area – it may be unreasonable to expect anything other than a slow and protracted recovery absent a further fall in the real exchange rate. In such an environment, there are limits to the ability of domestic policy to stimulate private sector demand as the economy adjusts to a new equilibrium. But the Committee has not lost faith in asset purchases as a policy instrument, nor has it concluded that there will be no more purchases.

When finalising today’s projections, the Committee took account of the Government’s decision to use the cash accumulating in the Bank’s Asset Purchase Facility to reduce the stock of

government debt. The effect of that action was judged to be broadly equivalent to purchasing gilts to the value of the cash transferred. This does not mean that the MPC is no longer in control of monetary policy. The MPC can always offset the effect of the arrangement on monetary conditions.

The immediate economic outlook remains a challenging one. Growth is likely to remain sluggish and inflation above target. The road to recovery will be long and winding. But there are good reasons to suppose that we are travelling in the right direction. The Committee stands ready to do whatever it can to keep us on the right path.