Report to Treasury Select Committee
Ben Broadbent, External Member, Monetary Policy Committee
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Voting record

The last year has seen a marked improvement in sentiment in financial markets, a gentle rise in UK economic activity, albeit one that has been obscured by exceptional trends in particular sectors, and rates of inflation that remain above target. It is against this backdrop that I have not voted to expand further the stock of asset purchases.

The improvement in financial markets – particularly marked in the case of banks' funding costs (both debt and equity) – dates from the middle of last year and may, at least in part, owe something to initiatives and statements of central banks around that time. The Bank of England, in conjunction with the Treasury, announced last June the creation of the Funding for Lending Scheme, since extended; in July 2012 the ECB declared it would do "whatever it takes to preserve the euro", and shortly afterwards announced the Outright Monetary Transactions programme (it has since cut its official interest rate as well); in September the US Federal Reserve re-launched its own asset purchase programme and, subject to the stability of inflation expectations, pledged to continue to ease policy until the labour market improves sufficiently.

Some have questioned whether financial markets have over-reacted to these developments, and even whether easy monetary policy has encouraged excessive risk-taking. It hardly needs saying that central banks need to be alert to the dangers of excessive risk in the financial system and, even after the creation of the Financial Policy Committee, that duty extends to the MPC. But I do not yet see any great cause for concern. Equity prices are still 20% below their recent peak in real terms, that much further relative to corporate earnings. Meanwhile, credit extended to non-bank financial companies has stagnated over the past year and continues to fall relative to GDP. So my votes against further expansion of asset purchases are not motivated by a concern that monetary easing has done too much to prices of financial assets (or, for that matter, the opposite concern – much heard in 2012 – that it does little to anything).

What is true, however, is that improvements in financial markets have reduced the costs of funding real assets and, therefore, improved the prospects for investment spending, both here and overseas. This, in turn, makes me more confident that the central forecast in the Inflation Report, which envisages a steady improvement in growth – from less than 1% over the past year (to 2013Q1) to 1½% over the next year and 2% the year after that – are reasonable. Even this acceleration in activity is exaggerated by the sharp contractions in oil and construction output last year, declines which are unlikely to be repeated over the next year or two. And current business surveys are, for what it's worth, consistent with GDP growth closer (at an annualised rate) to 2% than 1%.

Though better than the recent past, growth of 1%-2% can hardly be described as strong. It is comfortably below the historical average, weaker still than the typical rate 3-4 years after a recession. So if underlying productivity were also to grow at its normal (2%) rate, and given continued growth of the workforce, the Inflation Report forecasts would imply widening spare capacity and, all else equal, downward pressure on inflation over the medium term. The difficulty for monetary policy is that productivity growth has been very weak, far weaker than one would expect (on past correlations) even given the path of output. It is still not clear what exactly has caused this shortfall and the likelihood is that several things have contributed to it. As I explained in a speech last year, I believe that one significant factor may be the difficulty the economy has had – partly thanks to a still-dysfunctional financial system – in adapting to the significant cross-sectoral shocks wrought by the financial crisis. If so, then it's quite possible that, as the financial system returns to health, and profitable opportunities are again exploited, productivity can again start growing – even, for a period, at an above-average rate. The difficulty is judging when that might happen and there is clearly a risk that, should monetary policy be eased too much in anticipation of such an improvement, inflation would remain above target for that much longer. It is these risks, not a concern with the instrument of policy *per se* (asset purchases as opposed to interest rates), that have persuaded me to vote to keep the monetary stance unchanged over the past twelve months.

The outlook

I have described how the central forecast in the May Inflation Report envisages a further improvement in economic growth, though not to above-average rates. I also said that part of the expected improvement, at least in the near term, relates to the moderation of the severe rates of contraction seen last year in two particular sectors, oil and construction. I will briefly explain the second point and then say something about wider sources of risk over the medium term.

In 2012, construction output is estimated to have fallen by over 8%, oil production by over 10%. These are relatively small sectors of the economy. But the declines were big enough to knock 0.8% off whole-economy output. Without them, in other words, the economy would have growth by 1.3% rather than 0.5%. In general, one should be wary about simply stripping out the weaker components of growth and assuming that these will correct while the rest of economy carries on growing at a similar rate (the same applies to the faster-rising parts of the CPI). But in this instance there are particular reasons for the severity of the declines last year – maintenance in the case of the North Sea, the lagged effects of reductions in public-sector investment in the case of construction – and particular reasons too for believing that, over the next couple of years, activity is more likely to grow than shrink (oil companies themselves envisage a stabilisation of output; government plans imply moderate increases in gross public-sector investment; there are also signs of firming activity in housing activity, including a rise in housing starts). So it is not unreasonable to expect a less negative contribution from these sources, not to say a slightly positive contribution, over the next couple of years.

More important will be the underlying macroeconomic risks and, of these, the most important still originate from the euro area. It seems to me unlikely that, on its own, monetary policy can unwind the imbalances that built up within the euro area before the crisis or offset the effects of them that have been so plain since. At best, it can buy time for the necessary adjustments to occur and, if this time is to be used profitably, other policy makers need to act too. The shape of a more sustainable euro zone, one that involves a greater degree of risk-sharing in banking regulation and fiscal arrangements, is now detectable. But there are probably further steps to be taken and considerable uncertainty still about how rapidly this will happen. In the meantime, it is hard to see how the euro zone can recover very rapidly (as might be expected in a "normal" cycle) and that will, in turn, continue to act as a drag on our own economy. This is partly why our own forecasts, for UK growth, remain relatively muted and why there is still a downward skew to the distribution.

Domestically, the key areas of uncertainty relate to the behaviour of the banking system and the path of productivity. As I said above, I think these two things may be related. And our forecasts entail a gradual (though unspectacular) improvement on both fronts. I think these are reasonable forecasts. But there's many a slip 'twixt cup and lip, and much uncertainty about how these things will evolve.

Explaining monetary policy

In the past year I have given three public speeches. The first, last September, was about productivity. I point out that cross-sectoral shocks will lower productivity unless resources are fully mobile in response; I conjecture that slow resource reallocation may help to explain weak productivity growth in the UK (and after other financial crises). The second, last November, discussed the outlook for the construction sector and argued that one might expect to see a stabilisation of output from the spring of 2013. The third, this May, was about forecasting errors. I suggest that people are typically too quick to judge forecasts and too ready to see forecast "errors" as precisely that – someone's mistake.
I also gave a seminar (unpublished) at Oxford University, in February, and wrote an article on inflation targeting for an "ebook" published by VoxEU in April.

I have given four on-the-record media interviews (to the BBC, the Northern Echo, CNBC and Bloomberg). I have also had several off-the-record meetings with journalists.

I have made seven Agency visits, to the North East, Great London (both in September last year), Wales, the North West (October 2012), Scotland (February 2013), the South West (April 2013) and East Anglia (May 2013).