Report to the Treasury Committee

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Economy and voting record

This is my first report to the Treasury Committee since joining the MPC in September 2017.

When I joined the MPC, CPI inflation was above our 2% target: it had been 2.9% in August 2017 and was expected to rise a little higher in the coming months before gradually falling back towards target. At the same time the MPC judged that a limited degree of spare capacity remained in the economy, although this was likely to be eroded further over time. I broadly shared the Committee's central assessment of the economy as set out in the August 2017 *Inflation Report*, and voted with the majority for no change in Bank Rate at my first policy meeting in September 2017.

By the time of the Committee's November meeting, a majority of MPC members thought that the margin of slack in the economy seemed fairly limited and that underlying inflationary pressures had shown some signs of picking up; as a result, they judged that this reduced the degree to which it was appropriate for the MPC to tolerate an extended period of above-target inflation, and voted to raise Bank Rate by a quarter of a percentage point – a small reduction in monetary stimulus.

I voted for no change in Bank Rate at that meeting, not because I disagreed with the overall framework for setting monetary policy, but because I had a different assessment of the economy at that time. In particular, I thought there might be a little more room than headline measures of slack suggested for the economy to grow without generating above-target inflation in the medium term. I wanted to wait for more evidence on the evolution of wage and domestic cost growth before beginning to withdraw some monetary stimulus.

In the months that followed there were a number of developments that provided me that evidence. In particular, by February 2018 annual wage growth in the data had picked up materially, including relative to what we had been forecasting in November 2017. These developments taken together left me more comfortable with the balance of risks around the MPC's central assumptions than I had been previously, and more confident that domestic inflationary pressures were picking up. The volatility in output introduced by the weather in early 2018, and the other downside data news that accompanied it, meant that I did not yet feel certain by the time of our May 2018 meeting that the time had come for another rise in Bank Rate. But the subsequent recovery in demand that followed, and the continued trend of rising wage growth, meant that by August 2018 I felt a further rise in Bank Rate was appropriate, and I voted with the rest of the MPC for an increase in Bank Rate to 0.75%.

Three further monetary policy developments over the past year have been relevant for me in my role as Deputy Governor for Markets and Banking. The first is the updated guidance on asset purchases that the MPC issued in June, where we expressed our intention not to consider the case for reducing the stock of assets that had been purchased by the Asset Purchase Facility at least until

Bank Rate reaches around 1.5%, compared to our previous guidance of around 2%. Second, in his June 2018 Mansion House Speech the Chancellor announced a capital injection of £1.2bn which enabled us to move the Term Funding Scheme onto our balance sheet, which we did on 19-20 January. The third was the Discussion Paper that the Bank published in August on our future balance sheet and framework for controlling interest rates, designed to help us learn more about the demand for central bank reserves over time and the factors that are likely to determine it. We have received a wide range of responses to the Paper; work is ongoing to review them and consider what conclusions we should draw from them.

The outlook

The key developments in the economy in recent quarters have been the increase in uncertainty about the resolution of the Brexit negotiations, against a backdrop of slowing world demand growth and tighter global financial conditions.

Uncertainty about Brexit has been weighing on UK domestic demand growth, which has slowed significantly in recent quarters. More than 50% of firms in the Bank's Decision Maker Panel of over 7000 firms now list Brexit as being in their top three sources of uncertainty; reflecting that, business investment has fallen in real terms for each of the past four quarters, and annual average GDP growth in 2018 was 1.4%, its slowest growth rate since 2012. This is borne out by what I have been hearing from the businesses I have visited on my regional visits.

Given the intensifying uncertainty about Brexit, I expect both these trends to persist into Q1, and agree with the MPC's judgement that even with weaker aggregate supply growth a small margin of slack is likely to open up this year. A striking feature of UK development since the EU referendum has been the weakness of business investment combined with the strength of employment growth. What I find concerning at the moment is that although employment remains at record highs, its growth rate now also appears to be slowing, so that demand for both capital investment and for labour appear to be softening.

In the MPC's February 2019 *Inflation Report* forecast, which is conditioned on a smooth transition to an average of end-states as well as on market paths for Bank Rate and the exchange rate, quarterly GDP and employment growth recover later this year and uncertainty subsides over time. Nominal wage growth continues to rise towards 3¾%, and excess demand builds. And inflation, which fell to 2.1% in December and has since fallen to 1.8%, as expected, in January, remains slightly above the 2% target in the medium term.

I thought the slight downgrade to potential output growth in our February forecast was appropriate given the further weakness in the productivity data and the continued uncertainty over Brexit, and informed by our latest regular supply stocktake. And further ahead, while I can see reasons for optimism in certain sectors – including in fintech – the persistent productivity weakness of the past few years and the MPC's history of past forecast errors seem more salient. But I would expect weaker-than-forecast productivity to be reflected mainly in weaker nominal wages, with little effect on unit labour costs or aggregate demand. And so I agree with the central judgement that once the near-term weakness in inflation – which largely reflects the impact of lower oil prices and from which I therefore take little signal – has passed, domestic inflationary pressures are likely to firm, keeping inflation above the Committee's inflation target in the medium term. I therefore also agree with the Committee's view that, conditional on the assumptions underpinning the *Inflation Report* forecast, including the Brexit conditioning assumptions, some limited and gradual ongoing tightening in monetary policy will be warranted over our forecast period.

We do not know yet, however, what the actual outcome for Brexit will be. How the economy evolves from here, and what the appropriate stance of monetary policy will therefore be, will depend crucially on what happens in the negotiations, and on the subsequent response of demand, supply and the exchange rate.

If, as assumed in the *Inflation Report* forecast, a smooth transition to a new trading arrangement is agreed, then some reduction in uncertainty and a partial recovery of demand seems likely in the near-term. What kind of trading arrangement is eventually agreed will also matter for longer-term supply growth, with less open trading arrangements associated with worse outcomes for productivity. And as demonstrated by the sensitivities that the MPC set out in a Box in the November 2018 *Inflation Report*, how the exchange rate responds will also be important: a transition to a relatively open trading relationship is likely to result in an appreciation. For all these reasons, different outcomes will have different implications for monetary policy.

A no-deal outcome would have more significant economic consequences and therefore more substantive implications for monetary policy. The scenarios that the Bank published at the TSC's request in November 2018 are a useful illustration of the possible scale of the effects – although it is important to stress they are scenarios of what might happen, not forecasts or projections of what would happen. Framed by scenario and sensitivity analysis, I agree with the MPC's collective view that the monetary policy response to Brexit, whatever form it takes, will not be automatic and could be in either direction. The actual response will as always be determined by the MPC's view of the trade-offs between keeping inflation at target and avoiding undesirable volatility in output, as set out in our remit.

Explaining monetary policy

Over the sixteen months since my appointment hearing in October 2017 I have given six on-the-record speeches (details below). Two were specifically on monetary policy issues, one covered my responsibilities for the Bank's balance sheet, and the other three linked my responsibilities in the Bank for financial infrastructure and fintech with the wider economy. I have tried where possible to draw out the links between my operational areas of responsibility in the Bank and the MPC's monetary policy setting.

Over the same period I have given several off-the-record talks and taken part in roundtables on monetary policy, fintech and the Bank's Future of Finance review. I have discussed my views on the economy in three interviews with regional and national newspapers.

I have made seven visits to different regions of the United Kingdom - the East Midlands, the North East, the North West, Scotland, Wales, East Anglia and London. I find my discussions with business and civic leaders on these visits extremely helpful in informing my views on wider UK economic outlook. I have also visited six schools to talk to pupils about the economy and the role of the Bank of England. In November 2017 I joined the other Governors in Liverpool as part of our "Future Forum" outreach programme, and in January 2019 I took part in the online version.

I have had regular meetings with other central bankers and members of the regulatory community, discussing monetary policy as well as other issues of mutual interest, including as a member of the BIS Committee on the Global Financial System.

I gave evidence to the Treasury Committee on the May 2018 *Inflation Report* as well as during my appointment hearing in October 2017.

Speeches

20 November 2017	Monetary Policy From End To End: Define, Decide, Deliver
23 February 2018	The UK's productivity growth challenge
22 March 2018	The Bank of England - Open to Fintech
07 June 2018	What's going on?
28 September 2018	Finding the right balance
06 December 2018	Setting standards