Report to the Treasury Committee

Dave Ramsden, Deputy Governor for Markets and Banking

19 February 2020

Economy and voting record

My previous report to the Treasury Committee was in February 2019. Since then, I have voted to keep Bank Rate unchanged at 0.75% in each of the subsequent eight Monetary Policy Committee meetings.

Two key developments have framed my assessment of the UK economy over the last year. Instead of abating, Brexit uncertainties intensified over 2019 as the Article 50 deadline was extended and the perceived risk of a cliff-edge outcome increased. And world growth did not pick up despite significant monetary easing abroad, as global trade tensions built further over 2019.

At the time of the January *Monetary Policy Report*, four-quarter UK GDP growth in 2019Q4 was estimated at 0.8%.[1] Rather than picking up through 2019 as the MPC expected in the February 2019 forecast, quarterly GDP growth slowed to zero in 2019Q4. Households and firms have responded differently. Four-quarter consumption growth, at 1.2% in Q4, slightly outperformed GDP, whilst business investment growth underperformed at 0.8%.[2] The labour market has remained resilient, and the unemployment rate was lower than expected a year ago, at 3.8% in Q4. CPI inflation turned out weaker than projected a year ago, at 1.4% in Q4, compared with the February 2019 *Inflation Report* forecast of 2% (although some erratic factors seem to have been at play in that quarter).

While consumption growth slowed in 2019, it has been supported by strength in the labour market. The low rate of unemployment and further increases in labour participation – a trend for several years now – have combined to generate record rates of employment.

Business investment, on the other hand, has underperformed other G7 economies since the EU referendum in June 2016. Based on estimates using survey responses to the Bank's Decision Maker Panel, that underperformance has largely reflected uncertainty around, and expectations for, the outcome of the Brexit process.

At the time of the November 2019 *Monetary Policy Report*, collectively, the MPC communicated that if global growth failed to stabilise or if Brexit uncertainties remained entrenched, monetary policy may need to reinforce the expected recovery in UK GDP growth and inflation.

By the time of the January 2020 MPC meeting, I was satisfied that global growth had stabilised and that Brexit uncertainties were easing. Global activity had stabilised, with the trough in four-quarter growth in 2019H1, and there were some more positive signs from indicators for 2019H2. There was evidence that Brexit uncertainty had fallen back. That was reflected in both a reduction in measures

[1] Subsequent ONS data revisions released alongside the first estimate of GDP for 2019Q4 mean that four-quarter growth turned out to be 1.1% in Q4.
[2] The ONS's first estimate of four-quarter business investment growth in 2019Q4 was 0.9%.

of sterling option-implied volatility (financial market measures of uncertainty around future values of the sterling exchange rate) and a fall in the share of firms in the Bank's Decision Maker Panel survey reporting Brexit as one of their top three sources of uncertainty.

As a consequence, I voted for no change in the stance of monetary policy at the January MPC meeting.

In my report to the Treasury Committee in February last year, I emphasised that I agreed with the MPC's view that how the economy evolves following the UK's withdrawal from the EU, 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.

Supply matters because it determines the pace at which output can rise without generating excess inflationary pressure: the "speed limit" of the economy. I set out my views on the UK's speed limit in a speech on the UK economy's resilience in May 2019. In that speech, I highlighted the risk that productivity growth might not recover to the extent embodied in the MPC's forecasts, in light of the persistence of the post-crisis weakness in productivity growth and the prospect that the Brexit process would reinforce this weakness, at least over the MPC's forecast horizon.

To evaluate potential supply growth and the amount of spare capacity in the economy, the MPC conducts an annual assessment of supply-side conditions. The latest assessment was set out in an 'In Focus' section of the January 2020 *Monetary Policy Report*. The two main conclusions, which I broadly agree with, were first that the MPC judged that there had been a slightly greater degree of spare capacity over the past few years than it had previously thought. And second, that productivity growth has continued to disappoint expectations. Subdued investment has contributed to the weakness in productivity growth since the EU referendum, further slowing the economy's speed limit.

The outlook

The United Kingdom left the European Union on January 31 2020 and, under the terms of the UK-EU Withdrawal Agreement, is now in a transition period before the beginning of a new relationship from 1 January 2021. Reflecting government policy, the MPC's January forecasts were conditioned on an immediate but orderly move, at the beginning of next year, to a deep free trade agreement between the United Kingdom and the European Union. The forecasts were also conditioned on market paths for interest rates and the exchange rate.

On the basis of the limited indicators we have had for this year, the early signs are that firms have become less uncertain about Brexit, and survey indicators related to economic activity in the period since the election have shown signs of some recovery. We have yet to see any hard data, but those indicators are consistent with a pickup in quarterly GDP growth from 0% in 2019Q4 to 0.2% in 2020Q1.

Looking further ahead, the Committee's January *Monetary Policy Report* forecasts were for four-quarter UK GDP growth to pick up to 1.4% in 2021Q1, 1.6% in 2022Q1 and 2.0% in 2023Q1. This outlook is predicated on four key judgements:

1. Global GDP growth is projected to rise towards potential rates;
2. Supply growth remains subdued over the forecast period;
3. The assumed recovery in global growth and reduction in Brexit-related uncertainty boost UK spending, such that demand growth outstrips supply growth; and
4. While CPI inflation remains below 2% in the first part of the forecast period, it returns to the target as the drag from energy prices wanes and domestic price pressures build.

Relative to those judgements, I think there are risks to the outlook in both directions.

I agree with the Committee's forecasts for a recovery in world growth, as global trade tensions ease further. The economic and trade agreement between the US and China that was announced in January supports that view. There are a range of risks to the international growth outlook, including downside risks as a result of the outbreak of the Covid-19 strain of coronavirus.

I thought the Committee's decision to revise down the outlook for productivity growth in the January forecast was appropriate. The Committee's forecast is consistent with a recovery in structural productivity growth from the ½% per year rates experienced over the past decade, to around 1% per year by the end of the forecast period. Given the persistence of subdued growth rates since the financial crisis and with the effects of the UK's new trading relationship with the EU still to come, my view is that the risks to the productivity outlook are still likely to lie to the downside, at least over the MPC's forecast horizon. But I would expect weaker potential productivity outturns to not have material implications for the setting of monetary policy, as I think they would be reflected in wage growth with little effect on unit labour costs or aggregate demand.

The outcome of the next stage of UK-EU negotiations on the future trading relationship remains uncertain, but overall I expect a recovery in business investment to take hold, based on the assumption of an orderly move to the new relationship. The reduction in Brexit-related uncertainty and the assumed recovery in global growth mean that demand growth is expected to pick up above subdued rates of supply growth over the forecast horizon.

The January *Monetary Policy Report* forecasts included a 0.4% boost to the level of GDP by the end of the forecast period from the September 2019 Spending Round. The MPC will update its view of the outlook in light of the Budget on 11 March.

I expect the resilience in the labour market to persist, and the MPC's January forecast is consistent with further falls in the unemployment rate as demand conditions recover. Tightness in the labour market supports wage growth in the region of 3-3½%.

Whilst inflation is currently below target, my view is that the conditions are in place to support a return to the 2% target over the forecast horizon, as building domestic price pressures come through. There has been ongoing debate on the Committee around the possible causes and likely persistence of the subdued rate of inflation we are currently experiencing. My view is that there are forces that may equally pose upside risks to the forecast, for instance as global integration weakens. We will continue to monitor the inflation outlook closely.

Looking further ahead beyond the short term, I think that, if the UK economy recovers broadly in line with the latest projections in the January *Monetary Policy Report*, some modest degree of tightening in policy may be needed to maintain inflation sustainably at the 2% target.

Explaining monetary policy

As part of the MPC's ongoing efforts to enhance its communication of its views on the economic outlook and its key policy messages, since November 2019 we have revamped the presentation of the forecasts through the new *Monetary Policy Report*, which replaces the *Inflation Report*.

Over the twelve months since my previous report to the Treasury Committee, I have given five on-the-record speeches (detailed below). One was specifically on monetary policy issues, one was in relation to the transition away from LIBOR at a conference hosted by the Bank, and three were in relation to my responsibilities in the Bank for financial infrastructure and fintech. One of those was at a conference in Shanghai, where I focused on the potential role of artificial intelligence in financial services and the opportunities provided by better use of data to support SME finance, both of which could, over the longer term, contribute to improved productivity performance. I have also: given three interviews, to the Daily Telegraph, Bloomberg and the Press and Journal; appeared on Bloomberg and CNBC TV; and given several off-the-record talks.

I have made seven visits to different regions of the United Kingdom – Scotland, Northern Ireland, the South West, Central Southern, the South East, the West Midlands, and Greater London. I continue to find these visits extremely useful in informing my understanding of UK economy.

On my regional visits over the past twelve months, I have spoken to several groups of secondary school children. I have also taken part in two Citizens' Panel events in August 2019 and February 2020. The Bank has established these events as a means of engaging directly with members of the public on the full range of economic issues related to our work as the UK's central bank. The Citizens' Panels promote the understanding of our work, and also enable us as policymakers to listen directly to the views of the public on how we are performing relative to our mission to promote the good of the people of the United Kingdom by maintaining monetary and financial stability.

Speeches

30 April 2019	Embracing fintech
08 May 2019	Resilience and innovation in post-trade technology
30 May 2019	Resilience: three lessons from the financial crisis
05 June 2019	Last orders: Calling time on LIBOR
27 October 2019	Openness and integration – the new finance and new economy in a global context