Report to the Treasury Committee

Dave Ramsden, Deputy Governor for Markets and Banking at the Bank of England

27th August 2021

Economy and voting record

My previous report to the Treasury Committee was in February 2020, shortly after the UK's exit from the EU, and just as the significance of the global outbreak of Covid-19 was becoming apparent; I noted in that report the downside risks posed by Covid to the global economic outlook.

Those risks subsequently crystallised very rapidly as the Covid pandemic took hold. In response, the MPC deployed its full range of policy tools in March 2020, cutting Bank Rate to 10 basis points, launching a new Term Funding Scheme with additional incentives for SME lending (TFSME), and announcing additional very substantial programmes of asset purchases, first in March, and again in June and November 2020. The most recent £150bn programme of purchases, announced in November, is still ongoing. £111.5bn of gilts have been purchased so far, and the programme is scheduled to complete by the end of this year.

The stance of monetary policy during the Covid period has been guided by the evolving economic outlook. In the initial phase of the crisis the priority was to support economic activity and employment, both with the goal of returning inflation sustainably to the MPC's 2% target, and to provide a bridge through the Covid crisis and minimise the potential for longer-term damage or 'scarring' to the economy's potential, as I highlighted to the TSC at the early March 2020 hearing. It was for that reason that I voted, along with my MPC colleagues, for the package of support measures I have just described.

Our March purchases also took place against a backdrop of extreme market disorder. Our purchases, alongside other policy measures here and abroad, were instrumental in restoring order, and indeed we deliberately carried them out at an unprecedentedly fast pace to achieve that; going "big and fast", in the words of the Governor Andrew Bailey. Had we not done this then that market disorder might, as we said at the time, have led to an unwarranted tightening of monetary and financial conditions, and an even sharper contraction in GDP.

As the economic outlook became somewhat clearer, the focus of monetary policy also evolved. While our ultimate goal remained to return inflation to target by bridging through the Covid crisis, our priority shifted to ensuring that the economy remained on track and that we were not blown off course as further risks crystallised.

We made this explicit in November 2020 when announcing our most recent £150bn programme of QE purchases, which we consciously decided to continue for an unusually long period through to "around the end of 2021": we said in our Minutes that "risk management considerations implied that policy should lean strongly against downside risks to the outlook." For the same reason we gave forward guidance in November that we "did not intend to tighten monetary policy at least until there was clear evidence that significant progress was being made in eliminating spare capacity and achieving the 2% inflation target sustainably." And we highlighted the asymmetry in our assessment of the risks to activity and inflation by noting that "if the outlook for inflation weakened, the Committee stood ready to take whatever additional action was necessary to achieve its remit".

In fact the economic news since November has been generally positive. Activity has been stronger than we expected, with Covid restrictions being eased slightly earlier than expected, partly due to the success of the vaccination programme in the UK. The UK labour market has also outperformed our expectations. UK CPI inflation rose to 2.1% in May and then to 2.5% in June, and while it fell back to 2.0% in the latest July data I expect it to pick back up to around 3% in the August data which will be published on 15th September. Reflecting the economic news, the MPC adjusted its guidance in May to make it more symmetric.

A further key theme of the period since my last report to the Committee has been the ongoing development of our 'monetary policy toolbox', much of which I have overseen from an operational perspective in my role as Deputy Governor for Markets and Banking, in addition to the Bank's wider interventions in financial markets in 2020 (including the TFSME, the Covid Corporate Financing Facility, and a wide range of liquidity support operations). In response to the effects of the Covid crisis the Bank's staff have performed an unprecedented 800+ market operations, carried out until recently entirely from home, and I want to pay tribute to their dedication and resourcefulness. Bank staff have also successfully carried out the necessary internal technical work to enable the MPC to set a negative Bank Rate and, as we noted in the August MPC Minutes, to support its transmission with a tiered system of reserve remuneration if appropriate.

As we set out in August, the Committee has also updated its strategy for the mix of our monetary policy tools and our intended approach to using the instruments in its toolkit to deliver any tightening in the overall stance of policy, should that be required. The MPC now intends to begin to reduce the stock of purchased assets, by ceasing to reinvest maturing UK government bonds, when Bank Rate has risen to 0.5% and if appropriate given the economic circumstances. That level of Bank Rate is lower than the MPC's previous assessment of the threshold for reducing the stock of purchased assets, which was previously 1.5%. In part that reflects the MPC's judgement that setting a negative Bank Rate is now part of its monetary policy toolkit, as well as its view that the impact of reducing the stock of purchased assets on monetary conditions is likely to be smaller than that of asset purchases on average over the past.

The economic outlook

The MPC set out its updated best collective judgement of the economic outlook in its latest Monetary Policy Report in August. My central expectation for the outlook is consistent with those forecasts. I expect GDP to recover, and to re-attain its pre-Covid level of output some time in Q4 this year, and unemployment to continue to fall back. Notwithstanding the decline in the latest CPI outturn, the economy is likely to experience a pronounced period of above-target inflation in the near term, peaking at around 4% in the second half of 2021. Importantly though the rise in inflation primarily reflects increases in energy and other goods prices, driven in part by temporary bottlenecks and shortages in individual markets, rather than underlying inflationary pressure. With spare capacity having been eroded over the past couple of quarters, as demand has outstripped the growth in effective supply, some excess demand is likely to emerge in the near term. But my central expectation is that the period of excess demand and above-target inflation is likely to prove transitory, such that in the medium term inflation is likely to fall back to close to our 2% target and demand and supply are likely to return broadly to balance.

Those forecasts are conditioned on the market path for interest rates, which rises gently over our three year forecast period. I agree with the judgement set out in our Minutes that, should the economy evolve broadly in line with our Monetary Policy Report projections, some modest tightening of monetary policy over the forecast period is likely to be necessary to be consistent with meeting the inflation target sustainably in the medium term.

As I set out in my most recent speech in July, however, I think of that central outcome alongside two potential alternative scenarios for the economy. One alternative scenario is a more persistent inflationary one, in which supply pressures do not ease and demand continues to pick up. The further easing of restrictions could, for instance, act as a further boost to household and business confidence, even as bottlenecks on the supply side persist; I have argued for some time that the long term supply effects of Covid could, despite the best efforts of policymakers, prove more substantial than assumed in our central forecast. Such a scenario could lead to a more sustained and widespread increase in inflationary pressure, particularly if the temporary inflation overshoot led households and businesses to expect high inflation to persist for longer. A variant on this scenario could also see demand weaken in part in response to sustained supply pressures.

A second alternative scenario meanwhile is one in which demand growth does not just moderate but instead weakens more substantially, alongside easing supply pressures. That could happen for instance if household confidence falters in response to rising Covid cases or if further new variants emerge. A combination of weaker demand and easing supply pressures could see inflation falling back faster in the medium term, not just towards but potentially back below our 2% target.

Overall I think the risks to the outlook for activity and inflation are two-sided. In terms of the two alternative scenarios I put more weight on the inflationary than the disinflationary one. However, many uncertainties remain, for the UK and globally. Consistent with my assessment of the outlook, I voted with the majority in August for no change in Bank Rate or the stock of QE. But I will be monitoring the data and newsflow, in particular the progression of the Delta wave of Covid and developments in the labour market, closely.

Explaining monetary policy

Over the eighteen months since my previous report to the Treasury Committee, I have given seven on-the-record speeches (detailed below). Four of those speeches were specifically on monetary policy issues, and three were in relation to my responsibilities in the Bank for bank resolution and fintech. I have also given six interviews, to Thomson Reuters, the Times, the Guardian, the Yorkshire Evening Post, Age Scotland and the Society of Professional Economists; I have also given several off-the-record talks. And I gave evidence, alongside Andrew Bailey and Ben Broadbent, to the Lords Economic Affairs Inquiry on QE, in addition to hearings with the Treasury Committee.

Covid-related restrictions have made it more difficult than usual to visit other parts of the country; but I have also made eight 'virtual' visits to different areas of the UK – the East Midlands, Central Southern England (twice), the North East, Scotland, the West Midlands, the South West, and Yorkshire and the Humber. I continue to find these visits extremely useful in informing my understanding of UK economy; I am looking forward to resuming visits in person in the coming months. As part of these visits I have spoken to a number of groups of secondary school pupils. I have also taken part in three Citizens' Panel events and two Community Forums. These outreach events play a crucial part in supporting the Bank's mission by enhancing public understanding and ensuring that we listen to views from every part of society.

Speeches

12 October 2020 – Opening remarks at the launch of the Artificial Intelligence Public Private Forum

21 October 2020 – The monetary policy toolbox in the UK

17 November 2020 – The potential long-term effects of Covid

17 February 2021 – QE as an economic policy tool - what does it do and how should we use it?

26 February 2021 – The UK's progress on resolvability

21 April 2021 – The Bank of England and fintech: public support for private innovation

14 July 2021 – Navigating the economy through the Covid crisis