Report to the Treasury Select Committee

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Economy and Voting record

When I last reported to the Committee we, the MPC, had recently published our November 2017 Inflation Report.

In that report, the MPC's assessment was that there was very little labour market slack left in the economy and that GDP was growing at slightly above its post crisis potential rate of around 1.5%. The MPC's forecast, its best collective view of the central path for growth and inflation, was that growth would continue at around this rate, generating excess demand over the forecast period. This would gently raise domestic inflation pressure, driven in part by faster pay growth. As a result, while the externally generated inflation from sterling's post referendum depreciation would wane, domestic inflation pressure would push inflation above target by the end of the forecast period. The Committee's assessment was that rates would need to rise gradually over the forecast period to keep supply and demand in balance and inflation at target. The majority of the Committee voted to raise rates at the November meeting.

As I made clear at the time, I shared the Committee's central view of the likely path of the economy. But I was less certain that it would generate sufficient domestic inflation pressure to push inflation to target, as the inflation from sterling's depreciation waned. The economy had grown steadily since the beginning of 2013 and over this period unemployment had fallen quickly to levels not seen for over 40 years. But domestically generated inflation pressure had remained muted over this period. There was, in my assessment at the time, no clear evidence that firms had sought to rebuild profit margins squeezed in the post crisis recession and pay growth had remained very weak over the period and had undershot the MPC's forecasts. It was unclear whether and, if so, to what extent, structural changes in the economy and in the labour market had affected the relationship between unemployment and pay and, more generally, the relationship between the balance of supply and demand on the one hand and inflation pressure on the other.

While, therefore, I subscribed to the Committee's central forecast, I wanted to see more evidence that diminishing slack in the economy was leading to domestically generated inflation pressure and specifically that pay growth was beginning to establish itself at rates consistent with the forecast. Given the experience of the past five years, the still unresolved post crisis puzzles around the rates of growth of pay and productivity, and the fact that rates would only need to rise relatively gently and to a limited extent over the forecast period, I judged at that point that the better course was to wait and voted accordingly.

In being prepared to wait for more evidence I was not, as I have made clear publically, arguing against monetary policy being forward-looking or suggesting that the likelihood of the next move in interest rates could be in either direction. My approach to policy was not about taking only one step at a time with no view at each stage about what the necessary path of policy is likely to be further out. It was, and remains, important for the MPC to have such a view and I endorsed the forecast with its gently rising path for Bank rate.

Rather, my view was that in a period where there remained significant structural uncertainties about the post-crisis economy and the relationship between the balance of supply and demand on the one hand and inflation on the other (such as that between pay growth and unemployment), there needed to be a higher evidential threshold for policy changes.

That has continued to be my approach to policy. In August, I judged that there had been sufficient evidence that domestic inflation pressures were increasing broadly in line with the MPC's forecast. Unemployment had fallen further and other indicators showed increasing tightness in the labour market. Most importantly while earnings growth had been volatile, for the first time since the crisis, shorter run measures indicated that pay growth was established above 2.5%. Given the evidence, my assessment in August was that a rate increase was appropriate.

The outlook

In line with the approach set out above, and in view of continuing structural uncertainties, there remains, in my view, a need for a somewhat higher evidential threshold for policy moves – some extra resistance in our policy reaction function. But this need for resistance in policy reaction has diminished over the year as the picture has become clearer and evidence has begun to accumulate of more familiar relationships between economic variables. My expectation is that it will diminish further over the future.

The MPC's November 2018 Inflation Report forecast, to which I subscribe, is for GDP to continue growing at about its potential rate through the whole forecast horizon. In the later part of the forecast period, as the impact of externally generated inflation pressure wanes, domestic inflation pressures, particularly pay, rise so that inflation is slightly above the target at the 3 year forecast horizon. Conditional on that forecast and within the general approach to policy set out above, I would expect a gradual tightening of monetary policy over the forecast horizon to be appropriate.

The outlook of course will be materially affected by the outcome of Brexit over the coming months. Our forecast is conditioned on a smooth adjustment to the average of a range of possible outcomes for the UK's eventual trading relationship with the EU.

As Brexit approaches, the uncertainties about the outcome, about the path to the outcome and, crucially, how outcome and path compare to the expectation of households, firms and businesses, means that we are increasingly as much in a world of scenarios as of forecasts. The forward looking indicators and current economic data upon which we usually rely for the near term are clearly being distorted by Brexit uncertainties and expectations.

On the official data, GDP growth in Q3 looks to have been strong – at 0.6% on the first release. But, in my view, that strength probably reflects a recovery of weakness earlier in the year and does not contain much information about the future.

Surveys of output and investment are pointing to subdued growth in coming months. October's PMIs, published this week, report a weakening in output with both services and manufacturing sectors reporting fairly marked falls. Reported expectations for future activity were even weaker, with the composite expectations index at its lowest since immediately following the referendum. In a similar vein, the CBI's quarterly industrial trends survey released in October had reported a fall in output and a particularly marked drop in export orders and optimism. In short, output surveys point to subdued activity in the near term.

Over the first three quarters of this year, business investment has been falling. The Bank of England's agency network reported that the results of its annual survey on capital investment intentions (in the field from August to October) showed that intentions for expenditure growth were the weakest in recent years (with the exception of the survey conducted immediately after the EU referendum) and, similarly, the BCC measure of investment intentions declined in its Q3 survey.

I believe the forward-looking indicators are in very large measure reflecting Brexit uncertainties.

Somewhat in contrast, UK household confidence has held up more. The GfK measure of consumer confidence is a little higher than it was at this time last year, currently sitting at around about its long-term average level. That is, in my view not pointing to strong consumption growth – households were reporting much higher confidence over 2014-16 –

but it is well above the levels seen in 2008-2013, and has remained in this ballpark for over a year.

How the economy actually evolves however depend on Brexit outcomes and to how they compare to current expectations of households, businesses and financial markets. Monetary policy will need to act in response to the relative evolution of supply, demand and the exchange rate.

In the November Inflation Report, the MPC set out how paths for supply, demand and the exchange rate might be affected by Brexit outcomes and how that, in turn, might affect policy. Demand will depend on how far and in what direction UK households adjust their spending in response to Brexit outcomes and similarly on the impact those have on business investment and UK exports. The supply capacity of the economy over the forecast period will be affected and reduced by any adverse change in the UK-EU trade regime and by any sudden disruption of economic activity. In some scenarios, that disruption may be faster-moving than typical changes to the supply side of the economy – for example, if exporting capacity becomes redundant. The exchange rate may appreciate – if financial markets were to upgrade their view of the economy in response to Brexit news – or they may depreciate if they become more pessimistic, as perhaps they might with a disruptive exit, with consequent effects on inflation in either case.

The appropriate response of monetary policy to any particular Brexit scenario will depend on the balance of these effects as they evolve.

Explaining monetary policy

Over the past twelve months I have given five on the record speeches (list below). Of the speeches, two were specifically on monetary policy issues.

Over the past year, I have given around thirty off-the-record talks on monetary policy and financial stability. I have made three visits to different regions of the United Kingdom – Greater London, the North West, and the South East – to explain the economic and financial outlook to local business leaders and to hear their views on these matters. On each of these trips, I visited a local school to talk to students about the role of the Bank of England.

I have discussed my views on the economy in interviews with regional and national newspapers and in radio interviews.

In November last year, I joined the other Governors in Liverpool as part of our ‘Future Forum’ outreach programme and I will take part in this year’s version in December.

I have had regular meetings with other central bankers and members of the regulatory community, including at the ECB General Council and the European Systemic Risk Board, the Bank for International Settlements, the G20 Financial Stability Board and G20 Finance Ministers and Central Bank deputies meetings. I have also maintained extensive contacts with the business and financial communities both here and overseas.

Speeches

14 November 2017	*The Phillips curve: lower, flatter or in hiding?*
9 February 2018	*Market-based finance: a macroprudential view*
26 February 2018	*Looking after our money*
5 June 2018	*Central clearing and resolution – learning some of the lessons of Lehman's*
13 July 2018	*A little bit of stodginess?*