Report to Treasury Select Committee

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Voting record

When I submitted my previous report, in February 2011, it was against the background of a weak growth outturn in 2010Q4 and elevated inflation. At that point, it was unclear whether the weak fourth-quarter growth figure was indicative of a temporary soft patch of the sort often seen during recoveries, or whether it represented a more durable slowing in the rate of expansion, as the joint headwinds of fiscal consolidation and the squeeze on household real incomes from higher VAT, energy and import prices hit home. While there was necessarily uncertainty about this, on balance I expected growth to resume at a moderate pace, broadly in line with the Committee's *Inflation Report* projections. Twelve-month inflation looked set to remain in the 4-5% range for the rest of the year, before dropping back in early 2012 as the January rise in VAT and rises in petrol prices around the same time dropped out of the calculation. But I was uncertain how rapidly it would return to target and felt there was a risk that the period of above-target inflation might persist for somewhat longer than in the Committee's central projection. As a consequence, I was edging towards voting to begin withdrawal of the monetary stimulus.

In the event, in the first half of the year growth turned out to be somewhat weaker and inflation a little higher than anticipated. In part, that was down to external inflationary pressures proving more resilient than expected. In turn, that intensified the squeeze on household real incomes, leading to weaker growth in domestic demand and activity. When both activity and inflation are low (or high), it is clear which way policy needs to move. But supply shocks, including movements in external prices, move activity and inflation in opposite directions. Although our inflation target is for 2% inflation at all times, the Remit from the Chancellor makes clear that we should also seek to avoid unnecessary volatility in output. In practice, that means looking through the short-term inflationary impact of supply shocks, provided that inflation comes back to the target in the medium term. Given the uncertainty, I therefore felt in the spring and early summer it made sense to maintain the existing policy stance.

There then came a significant worsening in conditions during August, largely reflecting heightened market concerns about the ability of euro-area policy makers to handle the indebtedness and competitiveness problems afflicting several members of the euro-area periphery. In particular, Italy – hitherto immune – found its sovereign debt yields rising sharply. Alongside the heightened sovereign yields in the euro-area periphery, funding conditions for European banks generally worsened, posing the threat of a renewed tightening in credit availability, and a slowing in demand generally as a result of the heightened uncertainty.

As a result, at our September meeting, I considered whether to vote for a further stimulus to demand by re-starting our asset purchase programme. In the event, I decided – in common with most of the rest of the Committee – to wait to see if forthcoming meetings of euro-area policy makers produced an improvement. As that did not happen, at the October meeting I voted for such a further stimulus, namely £75 billion of purchases, taking until February to complete. Our November *Inflation Report* projections suggested that further purchases would be necessary to meet the inflation target in the medium term, but I did not judge it necessary to endorse that ahead of the February meeting.

Although conditions have improved somewhat recently – largely as a result of the ECB's long-term refinancing operations – the outlook for growth and inflation led me to support a further extension of the asset purchase programme at our most recent meeting.

The outlook

My views on the outlook are similar to those embodied in the Committee's latest projections. Abstracting from near-term volatility due to the Queen's Diamond Jubilee, I expect very subdued growth in the first half of the year, followed by a gradual strengthening, reflecting an ease in the squeeze on household incomes as inflation falls, complemented further out by some recovery in investment. The headwinds from de-leveraging, tight credit conditions and the fiscal consolidation suggest that a margin of spare capacity is likely to persist. As we have made clear in the *Inflation Report*, there is considerable uncertainty about the impact of the crisis and the recession on potential output.

Inflation has, as expected, already fallen back sharply from its September peak of 5.2%, and is now half way back to the target. I expect it to continue falling back in the near term, as movements in energy and import prices last year drop out of the calculation. There is, however, some uncertainty about the speed at which inflation will fall back after that. In large part, that depends on how productivity and labour market slack evolve and how they impact on pay, as well as on whether consumer-facing firms seek to re-build squeezed profit margins. I am, if anything, slightly north of the Committee's best collective judgement on this.

Although there are, as always, many risks to the outlook, the biggest one remains of disorderly developments in the euro area, impacting on the UK economy through trade, banking and confidence channels. These could be material, depending on how events unfold. But there is little that we can do to forestall them through monetary policy.

Explaining monetary policy

Since my previous report in February 2011, I have given six on-the-record speeches on monetary policy issues, together with numerous off-the-record presentations to a variety of audiences. I made six regional visits (to Northern Ireland, Swindon, Lincoln, Liverpool/Manchester, Darlington and Glasgow) involving various meetings and events with local business people. I also attended a variety of events with journalists, City economists and market participants. Finally, as Deputy Governor for Monetary Policy, I also represent the Bank's views in a number of international settings, including G7, G20, and the OECD.