Report to the Treasury Select Committee

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Voting Record

In the last year I have voted to expand the size of the Bank's asset purchases, and then to maintain them at £200bn and hold Bank Rate at 0.5%.

I joined the MPC following exceptional falls in output and substantial increases in unemployment. Although output stabilised in the second half of 2009 the level of GDP in the first quarter of 2010 remained more than 5% below its pre-recession peak. CPI inflation fell to 1.8% in June 2009 remaining below target until December and then rising to above 3%. But I believe underlying domestically generated inflationary pressures are not strong. Although there may have been some reduction in the supply potential of the UK economy the scale of the decline in the level of GDP suggests that spare capacity remains substantial.

Following the financial crisis the balance sheet of the UK banking system has been impaired. We are still on an adjustment path towards a sustainable pattern for the price and availability of credit. Asset purchases, and maintaining a low level of Bank Rate, are a means to stimulate spending, smooth the adjustment taking place within the financial sector and limit the impact of that adjustment on the broader UK economy. I believe that the Bank's asset purchases have contributed to the recovery of many asset prices, particularly of corporate bonds and equities, and have helped boost issuance of such assets by non-financial companies.

I voted to expand the size of the asset purchase programme to £200bn at the MPC's August 2009 meeting and to £215bn in November. I believed that increasing the size of asset purchases to £215bn would provide greater insurance against the downside risks to growth and inflation from constrained credit supply. In some respects these risks have diminished as UK GDP growth has stabilised. This is why I have subsequently voted to keep the stock of assets purchased at £200bn. However, recent events in sovereign debt markets and in bank funding highlight the downside risks. Further asset purchases may be warranted at some point in the future.

CPI inflation has increased to above the 2% target. In large part, the increase in CPI inflation has been driven by rising commodity prices (particularly energy costs), import price increases in the wake of the large sterling depreciation in 2007 and 2008, and by changes in VAT. The recent increase in inflation does not reflect rising inflationary pressure stemming from demand outstripping supply in the economy. I believe that the underlying domestic inflationary pressures – once we strip out what are likely to be temporary effects (eg from VAT changes) – have not been strong. Wage pressures have been subdued, with settlements generally below 2%, despite a rise in household's near-term inflation expectations.

The Outlook

The economic outlook remains unusually uncertain. Hence, in setting monetary policy it is important to consider both upside and downside risks.

The banking sector remains fragile. Recently, concerns in sovereign debt markets focusing on the sustainability of fiscal policies in some European countries have led to tightening bank funding conditions. Conditions in the euro area are particularly important for the UK given its importance as an export market. In the UK net lending to individuals and non-financial companies has remained weak so a renewed tightening in credit conditions could have a significant impact on demand. If so, demand may pick up very slowly so that the degree of spare capacity in the economy continues to push down on prices in the medium term and CPI inflation falls back below the target.

This does not mean that I am comfortable with the current high rate of inflation. We continue to face the problem of balancing risks: risks that inflation above target lasts long enough to become ingrained in expectations and affect behaviour so that it is hard to bring down, versus risks that the recovery in output becomes weaker and then disappears, leaving inflation pressures lower than is consistent with the target further ahead.

There is a risk that a protracted period of high CPI inflation could lead to higher inflation expectations becoming entrenched. So far, measures of households' medium-term inflation expectations have not increased much and there is little evidence that any rise in inflation expectations has led to higher wage growth. Without a pick up in wage inflation I do not think it likely that inflation being significantly above target is sustainable. Of course wage pressures may build significantly over the next year, though I do not believe this is the most likely outcome. Risks of an extended period of low growth – which would further weaken those pressures – are also real.

Explaining Monetary Policy

Over the past year I have made several visits to areas outside of London, including Northern Ireland, Scotland, the Southwest and Wales. I met a range of companies and talked to business groups to hear their views on the economy. These meetings were extremely helpful, particularly in understanding the impact of the credit crunch on smaller and medium sized companies.

To communicate my views on monetary policy more widely I have given several interviews (to amongst others the Belfast Telegraph, Independent, South Wales Evening Post, Sunday Herald, Daily Mail, Financial Times).

I have also spoken at a number of schools to explain monetary policy.

My published speech in Bristol on Wednesday 14th July was my fourth in the last twelve months. I have considered it particularly important to explain the MPC's asset purchase programme (quantitative easing) to the public. I discussed the efficacy of the asset purchase programme in my speech in Belfast, in August last year and at Imperial College London in February this year. A key consideration in formulating monetary policy has been the adjustments taking place in the financial sector which I discussed in my speech at Bloomberg in London in December and recently in Bristol.