Report to the Treasury Select Committee
Professor David Miles, External Member, Monetary Policy Committee
12 September 2013

Voting record

In the last year I have voted to hold Bank Rate at 0.5%. In June and July of last year, I voted to increase the size of the Bank's asset purchases by £50bn to £375bn; this policy gained a majority at the July MPC meeting. While these purchases were conducted by the Bank during August to October, I did not vote for additional asset purchases. From November last year onwards, I thought further stimulus was warranted. From November to June, I therefore voted to increase the size of the Bank's asset purchases by £25bn to £400bn. During this time, I remained in a minority. In July and August this year, I preferred to hold off making additional asset purchases: in July, the MPC was assessing whether it should adopt some form of forward guidance from August onwards. So the execution of any asset purchases decided upon in July risked overlapping with the introduction of forward guidance. I voted in favour of adopting forward guidance in August. In both July and August it seemed prudent to first assess the initial impact of forward guidance – on financial markets and on the wider economy – before deciding whether to provide additional stimulus to the economy.

In summary, I have consistently voted for a very expansionary monetary policy stance during the past year – despite inflation having remained above target. This is consistent with the Bank's remit: the remit allows the Committee to extend the period over which it intends to return inflation to the target if the economy has been hit by shocks, provided that such an approach remains consistent with meeting the inflation target in the medium term.

The UK economy is still recovering from one of the largest crises in its history. GDP is about 3% below its pre-crisis level of 6 years ago; growth has picked up but slack in the labour market remains very significant. Annual CPI inflation, having declined sharply from its peak in 2011, remains above target and is likely to be near 3% for some months. Energy and food price shocks and rises in a range of administered prices have contributed to the continuing overshoot of inflation. These shocks have a temporary – though nonetheless quite long-lasting – effect on inflation; but they do not reflect underlying domestically generated inflation pressures. Those pressures look weak: wage settlements have been at exceptionally low levels for many months and show few signs of accelerating.

In the medium term, inflation is likely to be lower. Medium-term inflation is determined by the interplay of supply and demand. The larger the gap between the economy's supply capacity and demand, the more inflation is pulled down, though the strength of that downward pull is not great and probably weaker now due to the cyclicality of productivity. I continue to believe that there is still substantial spare capacity in the economy. The unemployment rate remains considerably above the level at which one would expect wage growth and inflation to accelerate. There remains a large pool of short-term unemployed, most of whom are likely to be willing to work at existing wages if they were able to find a job. Stronger net immigration might also contain wage growth once prospects improve in the United Kingdom. I also believe that there remains substantial spare capacity at firms. Some firms will be able to re-activate mothballed capital. In others, employees will be able to work more productively: for example, by spending more time providing goods and services and less attempting to win contracts. As a result, labour productivity is very likely to pick up once growth gains pace, putting downward pressure on firms' costs and inflation.

The existence of spare capacity; the risk that the economy's supply potential declines, perhaps permanently, if output lies below potential for a prolonged time; and the temporary nature of the shocks that drove up inflation justify, in my view, a very expansionary monetary policy for some time to come.

The outlook

There are signs that a recovery is taking hold in the UK economy. GDP appears to have increased by about 1% in the first half of 2013. Business surveys and reports from the Bank's Agents have become more positive over the past quarter, and retail sales have grown strongly in July. This is welcome news after a sustained period of almost no growth. Nonetheless, I believe that this is not enough to make material in-roads into the margin of slack in the economy. And there remain significant risks to growth, including the size of export demand from the euro area and the amount of credit supplied by the banking sector.

We continue to face the question of what price the MPC should be willing to pay in terms of a more gradual return of inflation to target in order to help the economy return more quickly to capacity. Forward guidance is a framework within which the MPC can explore the scope for further economic expansion without putting price and financial stability at risk. It provides greater clarity about the MPC's view of the appropriate trade-off between the horizon over which inflation is returned to the target and the speed with which output and employment recover. Forward guidance reduces the risk that more encouraging data on the real economy triggers an exaggerated response in people's expectations about how quickly monetary policy might be normalised; it may also enhance the effectiveness of any additional monetary stimulus that may be appropriate.

Explaining monetary policy

Since I presented my previous report last year, I have visited and spoken to many businesses operating in a wide range of sectors in various areas of the country, including Wales, the Midlands, the West of England, Southern and Eastern England, Scotland and Northern Ireland.

To communicate my views on monetary policy I have given five public speeches at universities and at conferences (Scottish Economic Society; University of Bath; Economic Conference of the Federal Reserve Bank of Boston; Global Borrowers and Investors Forum). I have participated in roundtable discussions and have given several interviews (including to *The Guardian; The Times; The Financial Times; The Scotsman; the Belfast Telegraph; the Bangor and Anglesey Mail; the Evening Standard; the Basildon Echo; the Today Programme of the BBC; and Sky).*