Report to the Treasury Select Committee from Professor David Miles, External Member, Monetary Policy Committee

VOTING RECORD

In the last year I have voted to hold Bank Rate at 0.5%, and to keep the size of the Bank's asset purchases at £375bn. I have consistently voted for a very expansionary monetary policy. Even though GDP has grown at about 3% per annum over the past year and unemployment has declined rapidly, nominal wage growth has remained relatively weak, and annual CPI inflation has declined to below target.

Having Bank Rate at 0.5% while the economy is growing above the likely trend rate is not a sustainable setting for monetary policy. I have voted for such low rates because I believe that there is still sufficient spare capacity to keep inflation low, with both cost pressures on firms and inflation expectations of households relatively subdued. Most of the slack in the economy is in the labour market where there is an unusually large proportion of people who would like to work more hours than they are working. There is probably also an additional, limited degree of hidden unemployment among the self-employed. I believe there is rather more slack in the labour market than the central view of the MPC.

I supported the MPC's decisions to give more explicit guidance about how the central bank would respond to changes in the economic environment. This appeared particularly valuable at a time when uncertainty about the robustness of a recovery was very large in the middle of last year. When signs of a more sustainable recovery emerged in the second half of 2013, there was a risk that they would trigger an expectation of a sharp increase in interest rates because people might expect Bank Rate to get back to its pre-crisis average quite quickly. Forward Guidance reduced the chances of this happening and has allowed the recovery to build up some head of steam.

THE OUTLOOK

The MPC's latest central forecast, which I believe is plausible, shows a central expectation that inflation will stay near the target (see the August *Inflation Report*). Wage growth is likely to recover, and supply capacity is likely to expand as investment and labour productivity both increase. Because the inflation outlook is benign, with both cost pressures on firms and inflation expectations of households relatively subdued, I do not think there is immediate urgency about starting on the welcome path to a more normal setting for monetary policy.

When the right time will be to begin raising rates is something that reasonable people can disagree on. What is important is that this process of normalisation will not be bad news, unlike most interest rate rises in the past. In recent British history, rising interest rates have generally been painful for two reasons: they often started because inflation had got out of control and, partly as a result of that, they were often eye-wateringly sharp. Today inflation is just under 2% and it is likely that it will remain subdued for some time to come.

While it is hard to judge how much slack there is, the continued subdued outlook for costs means that it is likely that the path of normalisation in policy can be gradual. There are also reasons to believe that the neutral level of Bank Rate – the level consistent with the economy growing in line with potential, and inflation being at target – will for a considerable period be materially lower than it was before the financial crisis. One reason is that households, firms, investors and banks now probably attach a higher probability to deep recessions and to the associated difficulties in repaying loans than they did before the financial crisis. This makes assets which generate a real return with little risk more attractive, driving down the real risk-free interest rate. It also makes the wedge between safe rates (eg on gilts) and the rates of return required on riskier assets (eg mortgages) greater. The spread between mortgage interest rates and Bank Rate, or yields on short dated gilts, will probably remain significantly higher than was the case in the years leading up to the financial crisis. This will tend to reduce the neutral level of Bank Rate.

While these things seem likely, there can be no commitment to a particular path for Bank Rate. That is because judgements on underlying features of the economy – for example the sustainable path of labour productivity – are subject to great uncertainty. It is also inevitable that new shocks will hit the UK. So the timing, pace and extent of rate increases must depend on how the economy seems to be evolving.

EXPLAINING MONETARY POLICY

Since I presented my previous report last year, I have visited and spoken to businesses operating in a wide range of sectors in various areas of the country, including the Midlands, the North East, the North West and Yorkshire & the Humber.

To communicate my views on monetary policy I have given several public speeches at universities and at conferences (Northumbria University, Newcastle; the Federal Reserve Bank of Dallas; the Mile End Group, Queen Mary College, the Federal Reserve Bank of Boston). I have participated in roundtable discussions and have given several interviews (including to *the Northern Echo, Bloomberg TV, BBC Radio 2; BBC Breakfast, The Yorkshire Post, and BBC Radio 4 and The Times*). I have also written op-ed pieces for several newspapers.

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