Report to the Treasury Select Committee

Gertjan Vlieghe, External Member of the Monetary Policy Committee, Bank of England

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Voting record

I joined the MPC a year ago. At the time, GDP growth was around 2 ½ %, having slowed from a rate of around 3 ½ % in 2014. The unemployment rate was on a declining path, and had reached 5 ½ %. CPI inflation was around zero, in large part reflecting the fall in oil prices and a strengthening currency. Wage inflation had picked up to nearly 3%.

While the UK enjoyed growth above potential, the global environment was far from benign. Global growth had consistently fallen short of consensus forecasts. Growth rates in emerging markets were falling. A combination of slowing growth, falling oil prices and a rapid rise in emerging market debt had fuelled market concerns of a possible emerging market debt crisis, and the possibility of disorderly capital outflows from China.

A relatively resilient outlook in the UK and US, against a disappointing global backdrop with downside risks, had led to an appreciation of the USD and GBP exchange rates.

The question the MPC was grappling with was whether the resilient domestic outlook was sufficient to warrant a tightening of monetary policy, or whether the disinflationary effects from the global economy warranted patience.

There had been an expectation, both in financial markets and among some MPC members, that the moment when a tightening of monetary policy would become appropriate was approaching.

I voted with the majority for no change in Bank Rate, and I argued that the domestic and global outlook warranted patience before considering a tightening of monetary policy.

Domestically, while official data on wage growth had shown a pick-up to nearly 3% year on year, higher frequency measures showed that wage pressure was starting to ease again. Moreover, a wide range of other wage-related survey indicators had not shown the pick-up that was seen in the official data, so I argued there was substantial doubt about whether wage pressure was picking up at all. I argued that more evidence of a broad-based pickup across a wide range of indicators related to underlying inflationary pressure was required to justify a tightening of monetary policy.

Globally, I argued that debt deleveraging headwinds and adverse demographic trends would prevent global growth from improving in line with consensus forecasts, and that risks to the outlook for emerging markets were skewed to the downside. Related to the deleveraging and demographic arguments, I argued that the neutral rate of interest had fallen to very low levels, so that the current stance of monetary policy was not providing as much stimulus as comparisons with previous business cycles would suggest.

In the period between September and February, the tension between resilient domestic growth but weaker global growth, and the tension between resilient domestic growth but subdued inflation pressure, continued to be the main topics of debate on the MPC.

While risk of a full-blown emerging market crisis did not materialise, growth and inflation data did turn out weaker than expected. In successive Inflation Reports, the MPC revised down the outlook for domestic growth, for global growth, and for inflation. Financial markets repriced the future path of interest rates, and went from pricing in a gradual monetary tightening starting in a few months, to not pricing any tightening for several years, and some probability of a near-term easing.

From the turn of the year, an additional theme gained prominence in the MPC debates, namely the referendum on the UK's membership of the EU.

Changes in the perceived probability of the UK voting to exit the EU started to become more highly correlated with the GBP exchange rate. While the trade-weighted exchange rate had risen by 20% from its trough in 2013 to its peak in November 2015, by early April 2016 more than half of those gains had unwound.

The MPC also judged that the uncertainty surrounding the outcome of the referendum had started to affect domestic economic activity. In particular, there was evidence that commercial real estate transaction volumes had fallen sharply, and some indicators of business investment intentions had also fallen. Housing market activity also slowed through the second quarter, but that was more likely to be driven by fiscal and macro-prudential measures rather than by referendum risk.

While a range of economic indicators suggested that the economy had slowed in H1 2016, from around 2 ½% to less than 2%, it was unclear to what extent this slowing would turn out to be temporary, followed by a rebound in spending in the event of a remain vote. Macroeconomic and financial indicators had become less informative than usual about the underlying state of the economy. While I worried that a range of indicators on underlying inflation pressure remained too weak and might at some point warrant an easing of monetary policy, the prospect of a post-referendum spending rebound led me to continue voting for no change in policy in May and June.

When the referendum vote was to leave the EU, I judged that a summer rebound in spending had become highly unlikely. A slowing in growth was more likely, and the increase in inflation due to the sharp post-referendum drop in the exchange rate was likely to be temporary. I therefore voted, in a minority of one, for a 25bp cut in Bank Rate at the July meeting.

At the August meeting, somewhat more data were available to judge the initial effects of the referendum, and a full MPC forecast round permitted a detailed quantitative analysis of the outlook after a leave vote. I voted, along with the majority, in favour of a 25bp cut in Bank Rate, a Term Funding Scheme to reinforce the pass-through of the rate cut to the real economy, 10bn in corporate bond purchases and 60bn of government bond purchases.

The outlook

As outlined in the August Inflation Report, the vote to leave the EU is likely to have a significant impact on the UK economy. It will take time before new trading arrangements are in place. For a number of years, the trading environment may be less open. The anticipation of that new trading environment, and uncertainty surrounding it, is likely to weigh on private domestic demand.

The supply capacity of the economy is likely to be affected as well, due to a period of reduced foreign direct investment, reduced aggregate investment, capital re-allocation across sectors, and possible changes to the size and composition of the labour force.

But the demand effects are likely to dominate initially, so that the outlook is for a widening of the output gap and a rise in the unemployment rate.

Inflation is likely to rise towards the target more quickly than previously envisaged, and to exceed the target for a period, as the weaker exchange rate pushes up import prices.

There is substantial uncertainty about how much the economy will slow, about the balance of demand and supply effects, and hence about the medium-term path of inflation.

There were two key policy judgements underlying my vote for the August stimulus package. First, on the trade-off between growth and inflation, I judged that the optimal response is for monetary to stimulate demand now, to reduce the extent to which the unemployment rate is expected to rise. While this is likely to lead to a modest overshoot for inflation for a period, the exchange rate impact on inflation should eventually fade, allowing inflation to return to its 2% target. This path is preferable to one where inflation overshoots by less over the forecast horizon, but the unemployment rate rises by more, and inflation risks falling below the target after the exchange rate impact has faded, because there is still slack in the economy.

A second judgement was that it is better to stimulate now, despite having only limited information about how the economy is evolving, rather than to wait until more data are available. Because monetary policy works with a lag, policymakers do not have the luxury to wait until the impact of the referendum on the economy is clear before calibrating their response. Furthermore, given how low underlying inflation pressures already were before the referendum, and how low the neutral interest rate is likely to be, I judged that an earlier and more forceful monetary stimulus was justified than if inflation pressures had been closer to target already, to reduce the risk of medium-term inflation expectations drifting down.

The size and composition of the monetary stimulus package will be adjusted, if necessary, in light of further information about how the economy is evolving.

Explaining monetary policy

Over the past year I have given two on the record speeches and published an Op-Ed in a major UK newspaper. My speeches contained a longer-term analysis of the economic drivers of global real interest rates and the resulting behaviour of long-term real and nominal bond yields. They also covered the near-term outlook for the economy and monetary policy. I have given twelve off the record speeches to business, academic and financial sector audiences. I have made four visits to different regions of the United Kingdom – the West Midlands, the South East, East Anglia and Wales. I have given two interviews in UK newspapers. In addition to my Appointment Hearing, I have appeared before the Treasury Committee three times to explain my views on the economy and monetary policy.