Opening Statement to the Economic Affairs Committee

Tuesday 17 December 2013

Mark Carney, Governor of the Bank of England

Chairman, I am very grateful for the opportunity to give evidence to this Committee today. The sessions with Committees of both Houses are the cornerstone of the Bank of England's accountability to Parliament and, through Parliament, to the British people.

At this time of year it is natural to take stock. If I may Chairman, I have a few brief opening remarks reviewing progress on the Bank's responsibilities over the past year.

Inflation has fallen back to within a hair's breadth of the 2% target and the recovery has finally taken hold. The news about the strength of the recovery in the United Kingdom has consistently surprised on the upside and by more than in either the United States or the Euro Area (chart 1).

It is welcome that the economy is growing again, but a return to growth is not yet a return to normality. Nearly one million more people are out of work than in the years before the financial crisis, and the economy remains 2.5% smaller than it was in 2008.

The recovery has some way to run before it would be appropriate to consider adjusting the exceptional level of monetary stimulus that we continue to provide to the economy. In recognition of that, the Monetary Policy Committee introduced forward guidance in August, making clear that we will not even consider raising Bank Rate at least until the unemployment rate reaches 7%. That gives households and businesses the confidence that interest rates won't go up until jobs, incomes and spending are recovering at a sustainable pace.

The effect of forward guidance is evident in financial markets. Shorter-term interest rate expectations have not reacted as strongly as they have in the past to the sharp bounce back in expected activity (chart 2) and measures of market interest rate volatility have fallen notably (chart 3).

More importantly, forward guidance is having an effect in the real economy. My experience, having met with more than 300 businesses around the country, is that business people understand forward guidance well. This is confirmed by the reports of our network of Agents across the nation. What matters most for households and businesses is not market expectations of interest rates, but what actually happens to Bank Rate now and in the future. That is because the interest rates on 70% of mortgage loans to households and more than 50% of loans to businesses are linked to Bank Rate.

Our forward guidance framework builds in safeguards against the risks to inflation and financial stability that arise from an extended period of stimulus. In the event, inflation pressures are well contained at present, although we are monitoring inflation expectations closely. We are equally alive to the risk that extended stimulus could promote financial instability. With the adoption of forward guidance, we have made it clear that monetary policy is the last line of defence against such risks, with the Financial Policy Committee (FPC) taking the leading role.

In its most recent *Financial Stability Report* the FPC paid particular attention to the risks posed by the recovery in the UK housing market. These risks are manageable and are being managed. By acting in a graduated and proportionate way, we are reducing the likelihood that larger interventions will be needed later, and we are allowing the broader economy to continue to receive the stimulus it needs, for as long as its needs, to sustain the recovery.

Securing financial stability requires much more than a resilient housing market. The FPC and the PRA have acted to ensure that our major banks are adequately capitalised for expected future losses, a more conservative assessment of their asset risk weights, and future costs of redress for past misconduct. In total, UK banks' equity has increased by £140bn in the past 6 years and risk-weighted capital ratios have doubled.

The Bank remains at the forefront of the international effort to solve the problem of financial institutions that are too big to fail. Next year, the Financial Stability Board will be establishing standards on the amount, type and location of gone concern loss absorbing capacity that banks should hold to ensure they are resolvable in a crisis without taxpayer support. Alongside our international partners, the Bank is working to establish practical resolution plans for the major UK banks.

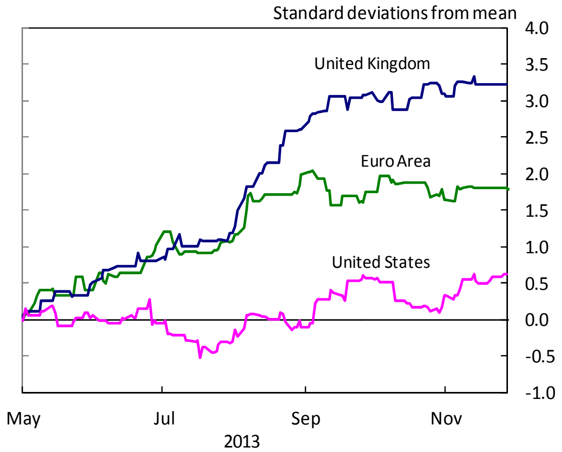
The Bank is also working towards creating more robust financial markets. An important part of that is catalysing more efficient and effective collateral management by backstopping private markets. Accordingly we have revised our sterling monetary framework to offer money and collateral for longer terms against a wider range of assets, to a wider range of participants, at more competitive costs.

The year has also seen the conclusion of the impressive work of the Parliamentary Commission on Banking Standards and the Banking Reform Bill, which benefitted from the wisdom of many here. The Bank will now take forward implementation of many of the Bill's measures, including ring-fencing of retail banking activities and the new Senior Persons Regime. As these reforms are given life, they should accelerate the rehabilitation of the financial sector so that it once again merits trust and is focussed on serving the needs of the real economy.

Chairman, those are the headlines from a very busy year at the Bank. I appreciate that the Committee may want to examine some of these issues, and the challenges for the coming year, in more detail and I look forward to your questions.

Annex

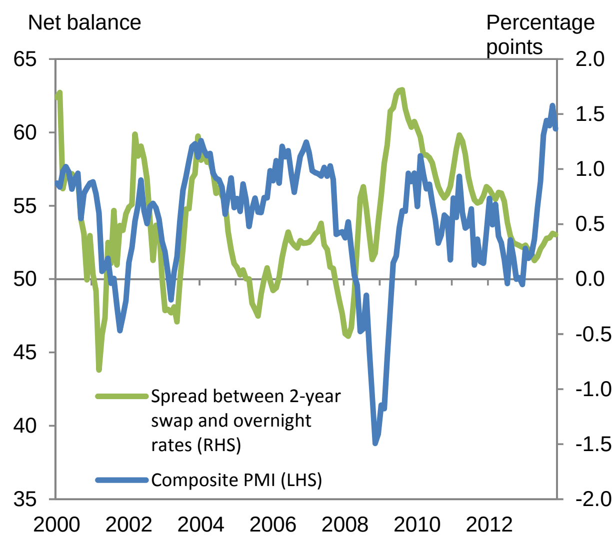
Chart 1: UK activity has surprised by more than in the US or euro area[1]



[1] The chart shows the cumulative sum since May 2013 of the normalised differences between selected indicators of economic activity and their expected value as surveyed by Bloomberg, divided by the square root of the number of releases.

Source: Bloomberg and Bank of England calculations.

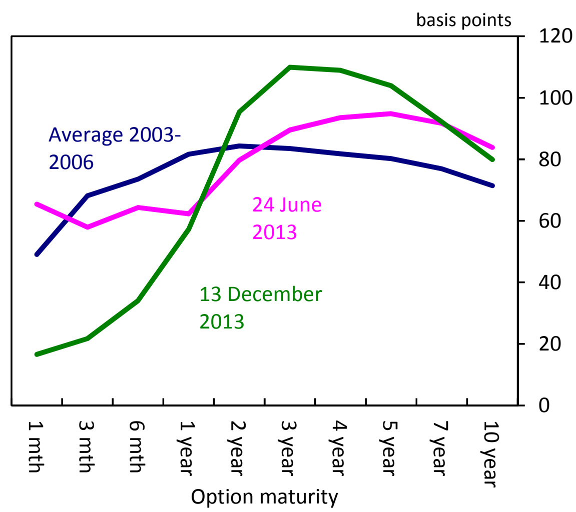
Chart 2: Shorter-term interest rate expectations have not reacted as strongly as in the past to the bounce back in expected activity [1]



[1] The green line shows the three-month moving average of the end-month spread between the 2-year swap rate and the SONIA rate. The blue line is a composite of the Markit/CIPS manufacturing and services PMIs.

Source: Bloomberg, Markit Economics, ONS and Bank of England calculations.

Chart 3: Uncertainty about short term interest rates has fallen since the introduction of forward guidance[1]



[1]The chart shows the normalised implied volatilities of options of varying maturities on one-year GBP interest rate swaps.

Source: Barclays Live and Bank of England calculations.