Report to the Treasury Select Committee
Dr Martin Weale, External Member, Monetary Policy Committee
27 November 2012

Voting Record

During this period there have been three distinct phases of asset purchases. The first was to buy £75bn of government debt; this began in October 2011 and was completed ahead of the February 2012 meeting. The second began in February and was to buy £50bn. The third, also to buy £50bn, was agreed in July and was completed ahead of the meeting in November 2012. I voted in favour of these rounds of asset purchases at the meetings at which the decisions were taken, and to maintain the stock at the relevant level at the other meetings. This meant that I was, on each occasion, voting with the majority of the Committee. After the asset purchases that began in February were complete, I voted, with the majority and against further asset purchases in May and June because I was concerned about the persistence of inflation. Despite these continuing concerns, I nevertheless voted for further asset purchases in July because it appeared to me that the economic situation had deteriorated both nationally and internationally.

These decisions were the outcome of two opposing factors. I thought that underlying inflationary pressures were somewhat stronger than those implied by the MPC forecasts in the period from November 2011 to August 2012. But I also took the view that, as I had said in November of last year for the first time, asset purchases probably provided a stimulus to output and inflation weaker than that assumed in the Bank's analysis. This meant that I thought the overall monetary stimulus provided to the economy from our asset purchases, from the various influences such as the Funding for Lending Scheme, and most recently from the Treasury's decision to use the interest accrued on our asset purchases to reduce the debt issue, were compatible with the inflation target.

The main source of my concern about inflation was the risk that wage increases would, relative to productivity growth, be larger than would be compatible with the inflation target. After a long period of above-target inflation, there is always a risk that the credibility of the inflation target will be reduced, creating a situation where it becomes all the harder and more costly to keep inflation close to target. Nevertheless, I had initially expected a stronger productivity performance and faster wage growth than we have seen over the last year.

Offsetting these concerns about inflation, the economy was also subject to substantial contractionary pressures and especially those arising from the effects of the crisis in the euro area. This had a number of influences. First of all, it directly reduced the demand for British goods in our largest export market. Secondly, it added to the general sense of uncertainty, and was probably a factor directly depressing investment and consumption spending. Thirdly, it pushed up bank funding costs, leading to higher interest rates to bank customers and a reduced willingness of banks to lend, affecting both households and firms. This background made policy action by the Bank desirable and it was with this in mind that I thought it right to support our asset purchase programmes. Starting in the summer, bank funding conditions have improved, helped by both improved market conditions in the euro area and the Bank's Funding for Lending

Scheme (FLS), but the improvement has not been so marked as to justify any reversal of the policy stance.

The Current State of the Economy

The November *Inflation Report* broadly represents my view of the growth prospects of the economy with a gradual move towards more normal economic growth. In the current quarter I would not be surprised if real GDP fails to grow, or contracts somewhat. Looking into next year, the positive sign from the lower cost of bank funding, combined with the fact that the FLS provides a strong incentive for banks to expand their lending, points to some improvement. The impetus from this may then trigger a gradual revival in investment with further support coming from an improved international situation. But associated with the economic stagnation has been an unparalleled period of stagnant or falling productivity and more normal growth will not be possible without a return to productivity growth. There has to be some risk that the recent economic stagnation will continue.

The weak productivity performance is probably accounted for by a number of different factors. One influence may be that, although employment has been rising strongly, the labour market is nevertheless not offering the same opportunities for career advancement as before. Other contributions come from the fact that investment has been weak and the North Sea oil production has been declining. It is also possible that low rates of interest, compared to previous recessions, have meant that inefficient firms have been able to carry on operating, while, at the same time, a limited supply of credit has made it difficult for new businesses to establish themselves and expand. Some of these factors, but not all of them, should abate if demand starts to expand. But it is not possible to be confident as to how far an increase in demand will be matched by a corresponding increase in supply and how far it will add to inflationary pressures.

The resilience of inflation while the economy has been so weak has proven to be a major challenge. While inflation may rise further in the near term, under the influence of increased prices of domestic energy, in the medium term I expect to see a drift back towards the target. It is, nevertheless, more likely than not to remain above target for much of the next two years. The reality is that there is a range of what might be termed administered prices, which may not be very sensitive to the balance between supply and demand. If these continue to rise at above the target rate of inflation, then other prices have to rise less rapidly for the target to be met. In turn this creates a risk that policy will need to be tighter than would otherwise be the case.

Activities

During the course of the year I have wanted to explain my continuing fears about inflation and also to communicate my views on quantitative easing. Since my previous report I have:

- Made four public speeches discussing economic circumstances and commenting on structural issues.
- Undertaken ten regional visits.
- Made thirty-five visits to companies as a part of these.
- Talked to twelve business groups.
- Given interviews to the *Daily Mail, Les Echos*, Sky News, Radio 4, Bloomberg and Dow Jones as well as regional newspapers and local radio stations.

Activities

Speeches
2011
NIESR talk (filmed by Bloomberg) – 25 Nov*
2012
Cass Lecture – 29 February
Hart Brown – 21 June
Manchester Economics Seminar – 21 Nov

Inflation Report Briefing
University of Bath Economics Society – 14 March
University of Ulster – 22 March
London Oratory School – 28 March
Investment Club Queen Mary University – 11 April
York – 17 May
West Midlands - 14 Aug
Northampton University – 15 Nov

Relevant Academic Events
Panellist at EUI nomics Workshop – 27 Apr
Royal Statistical Society- Presentation on Housing in the CPI - 15 August
ESRC Conference on the Future of Macroeconomics- Presentation on Data Needs - 2 October

Interviews
*Bloomberg
World at One
Les Echos
Daily Mail
Sky News
Dow Jones

Regional interviews
Bath Chronicle
Yorkshire Post/Scarborough Evening News
BBC Radio West Midlands
Birmingham Mail
Radio Scotland
The Herald
Surrey Advertiser

Business Groups
Clare City Dinner
Fathom Consulting
Barclays Capital
North East Chamber of Commerce
EEF, Surrey
MWMG & Whittingham Riddell
Downtown Liverpool in Business
CnES
Causeway Chamber of Commerce
North East Chamber of Commerce Panel members
Federation of Small Businesses (Northampton)
Highlands & Islands Enterprise

Agency visits – 35 visits to companies
South West – 13-14 March
Northern Ireland 22-23 March
North East – 25-26 April
Yorkshire & Humber – 17-18 May
Central Southern – 21-22 June
West Midlands – 13-14 Aug
Scotland – 23-24 Aug
Wales – 24 October
East Midlands – 14-15 Nov
North West - 21-22 Nov