Questions for Michael Saunders, from House of Commons Treasury Committee

Personal/General

1. Do you have any business or financial connections or other commitments, which might give rise to a conflict of interest in carrying out your duties as a member of the MPC?

No

2. Do you intend to serve for the full term for which you have been appointed?

Yes

3. During your term of appointment what areas in particular do you hope to focus your work in? What is your main priority for research in your term?

I intend to work on whatever issues are most important for the UK economic outlook and monetary policy decisions. At present, one key issue is the extent of remaining slack in the economy, especially in the labour market, and whether the repeated downside surprises in pay growth over recent years are likely to continue. Another key set of issues concern the effects on the UK economy of the decision to leave the EU, both in the near-term and further ahead. The process of EU exit is likely to affect both the demand-side and supply-side of the economy, as well as the labour market, while also potentially affecting the UK's neutral interest rate. Of course, other issues will probably arise.

4. How has your experience to date equipped you to fulfil your responsibilities as a member of the MPC? In particular, which areas of the MPC's work do you feel especially capable of contributing to, and which will require you to undertake additional research?

I have worked as a UK economist for nearly 30 years (since the late 1980s), initially as part of a small team and for the last 25 years as the sole UK economist at Citigroup (previously Salomon Brothers). In this role I have been responsible for forecasting and analysis of the UK economy and policy issues, with numerous written articles and presentations on the outlook. For the last 15 years or so, I have also been head of the Citigroup European economics team, managing a small team to cover the euro area, Switzerland, Sweden, Norway and Denmark. For the last 7 years or so, I was also been heavily involved in pulling together Citigroup's global economic outlook, which is published each month. All this has given me a thorough knowledge of UK economic issues and helped to broaden my understanding of the external issues facing the UK. In addition, I have on occasion been an expert witness for the Treasury Committee in its inquiries.

As discussed above, I believe there are plenty of economic and policy issues that merit further research and I would hope to do some work on these while also contributing to the MPC's discussions on the economic outlook and policy options, public appearances and so forth.

5. Have you published any research that is relevant to your role on the MPC?

I have written many articles on the UK economy in my previous employment, with a regular UK Economics Weekly, a full monthly UK economic forecast for the next few years and other pieces on topical issues. In the last few years, I also wrote a monthly global economic overview. These articles are for a fairly wide audience, rather than an academic audience. I attach three fairly recent pieces as examples. The TSC is, I believe, on the email distribution list for those articles. I have written occasional newspaper articles on economic issues and I attach a recent piece for the Sunday Times business section as an example. I also attach my first speech as an MPC member, given on 5 October.

6. What do you regard as the main challenges facing the MPC over your period as a member?

The key challenge, of course, is to fulfil the MPC's remit, which can be summarized as to set monetary policy to keep inflation on target (currently 2% CPI inflation) over time, in a way that helps to sustain growth and employment, and with regard to avoid exacerbating imbalances that could threaten the FPC's financial stability remit. At present, the issues fall into four parts: (a) the MPC's ability to produce a reasonable judgment of the economic outlook and risks, (b) deciding the appropriate monetary policy at a time when there seems likely to be a significant tradeoff between seeking to achieve the 2% inflation target and seeking to limit the variability of output around the economy's potential over the next 2-3 years; (c) the MPC's ability to communicate its views and policy decisions to businesses, households and markets in order to underpin the effectiveness of those decisions; (d) whether the MPC has adequate tools to implement its decisions effectively.

Economic Outlook

There are always uncertainties, but key challenges at present are:

(i) What are the longrun effects on the UK economy and financial stability of the decision to leave the EU? The exact nature of the UK's long-term arrangements for trade, investment and migration with the EU and other countries remains uncertain at this stage. External observers such as the IMF and OECD estimate that EU exit is likely to have a modest adverse effect on UK potential growth over time (the next 15 years or so) -- perhaps larger effects on some individual sectors -- but with considerable uncertainty over the scale and timing of these effects. The possible factors at work include reduced trade openness, reduced competition in some sectors, lower net inward migration, reduced inward investment, and the need to reallocate resources between different sectors. The same factors, along with the UK's persistent current account deficit, probably also imply a lower equilibrium level for sterling's real exchange rate. Indeed, sterling's trade-weighted exchange rate is roughly 15% lower than a year ago, with about three-quarters of that move after the referendum. For now, these judgments seem reasonable to me. But they may well need to be revisited as the details and timetable for EU exit become clearer.

(ii) How much will any longrun effects of Brexit affect the economic outlook over the next 2-4 years? I largely agree with the central forecast of the August Inflation Report that the economy is likely to see lower growth and higher inflation in the next year or two. The slightly weaker longrun outlook for the growth of real incomes and profits (ie the next 15 years or so) – plus elevated uncertainties over the UK's trade relations after EU exit – is likely to weigh on nearterm growth to an extent. At the same time, the recent depreciation in sterling (triggered in large part by the Brexit vote) is likely to lift inflation quite substantially from recent lows over the next 2-3 years, but fade further out. But I suspect the economy will not slow as much as the consensus and the August IR project in the next year or two, because of the support from financial conditions, the economy's recent momentum and ongoing supply-side advantages. The lower pound will give some boost to exports. The economic effects of Brexit are long-term in nature and uncertainties related to those may well have a less immediate effect on the economy than previous uncertainty spikes – which largely reflected more immediate crises. In addition, these uncertainty measures have fallen back recently, and a range of business and consumer surveys have rebounded from recent lows. Of course, if the economy is more resilient than many expect nearterm, this may not tell us very much either way about the longterm effects of Brexit (ie the next 15 years).

(iii) How much spare capacity is there? Pay growth has repeatedly undershot the BoE central forecast and consensus forecasts in recent years, despite lower-than-expected unemployment. The jobless rate (4.9%) is slightly below the 2001-07 average (5.1%), but pay growth is below 2½% now whereas it averaged around 4% then. I suspect that the labour market has more slack than the August IR implies, and that the economy's equilibrium jobless rate (the rate at which the growth of pay and unit labour costs are consistent with the inflation target) probably has fallen below 5%. Key factors behind this include lower long-term inflation expectations, the greater availability of migrant workers to meet specific labour shortages, the broadening in educational attainment over recent decades, and rising participation rates among older workers. In addition, changes to the tax and benefit system, notably the expansion of tax credits coupled with the low level and tighter availability of jobless benefits, have increased the incentives and pressure for people to be in work even if low-paid, rather than unemployed or out of the workforce.

Lower productivity growth may have played a role in capping pay growth, but the causality between pay growth and productivity growth probably goes both ways. The weakness in nominal and real wage growth has probably lifted the demand for labour, for example by encouraging the substitution of labour for capital as well as the expansion of labour-intensive sectors and sectors with relatively low levels of value added per head. So the economy has ended up with a mix of higher employment, lower productivity growth and relatively sluggish pay growth, rather than just lower pay growth.

Hence, even though the jobless rate is slightly below the average of the pre-crisis period, I expect the growth of pay and unit labour costs in the year ahead to remain somewhat below the rates consistent with the inflation target. This view does not preclude the possibility that productivity growth will pick up longer term, especially if and when the labour market is tight enough to generate more substantial upward pressure on pay.

(iv) How much stimulus is the current monetary policy stance providing? Long-term real interest rates across the world have fallen by about 450 basis points over the past 30 years. Research by the BoE and others suggests that a range of factors are at work, including demographic forces, higher inequality and higher precautionary saving by emerging markets. Nominal levels of investment have fallen as a result of the falling relative price of capital. Investment additionally has been capped by lower public investment, and the increase in the spread between risk-free and actual interest rates.

The decline in longterm neutral rates has not been caused by monetary policy. But the same factors that have lowered longterm real rates probably also have lowered the neutral real policy rate (although not necessarily to the same extent), a process reinforced by some shorter-term cyclical factors (eg balance sheet repair after the 2007-09 crisis, global fiscal consolidation in recent years). This has probably limited the stimulus from cutting Bank Rate to its current record low and expanding QE (or, viewed differently, has required the MPC to loosen policy more – and for longer -- than generally expected to support output). For example, the real policy rate (Bank Rate less CPI inflation) has fallen from about 3% on average in 2001-07 to slightly below zero now (and the "shadow" real rate, allowing for QE, is even lower), but part of this drop is just keeping pace with the lower neutral rate rather than adding stimulus by pushing real rates below neutral.

Recently published BoE research (see BoE working paper 571, December 2015) suggests that the global neutral interest rate is unlikely to fall much further in coming years, but also is unlikely to rise significantly. If so, then it may become easier to gauge the appropriate monetary stance. But the causes of the downtrend in neutral rates are still not fully understood, and hence projections of the neutral rate have to be treated with caution. If the neutral rate were to fall further, the current policy stance would be providing less stimulus than intended, leading to renewed disappointment in growth, prospects of a persistent inflation undershoot and greater challenges to extend the monetary policy toolkit. Conversely, if the factors behind the collapse in neutral global real rates were to fade, such that the neutral rate rebounds significantly, then you would probably see evidence that nominal GDP growth is surprising on the upside, and monetary policy would probably have to play catch-up.

(v) whether economic data and surveys are able to reflect UK economic developments with reasonable accuracy in a timely fashion, in particular given the ongoing major structural changes from, for example, the expansion of the "gig economy" and small business formation, changes in the pace of inward and outward migration, globalization of supply chains, expansion of knowledge-intensive services, EU exit, fin-tech etc. Given these uncertainties, I expect to put considerable weight on labour market and money data, as well as business and consumer surveys as well as the regular ONS activity data.

Policy tradeoffs

In the next 2-3 years, the MPC are likely to face a much tougher trade-off between slower growth and rising inflation than in recent years. As noted above, the vote to leave the EU is likely to have some dampening effect on economic growth in the next few years, while sterling's recent depreciation (partly triggered by the vote to leave the EU) is likely to lift inflation – probably pushing it above the 2% target over the next 2-3 years. This currency effect is likely to fade further out. In other words, the inflation path over the next 2-3 years probably will be lifted by the adjustment of the exchange rate to the process of EU exit, and thereby overstate the UK's medium-term inflation prospects once that initial adjustment is past.

There have been several previous episodes in which the MPC has tolerated a major deviation of inflation from target in the next year or so because they expected inflation to be back to target 2-3 years ahead. But this is really the first time that the MPC has clearly faced the prospect of an inflation overshoot amidst continued slack at the 2-3 year horizon.

With this outlook, the MPC needs to consider the appropriate tradeoff between the aim of returning inflation to target over the usual 2-3 year horizon versus the aims of supporting the economy against potential near-term downside and avoiding a renewed inflation undershoot further ahead as the currency-driven boost to inflation fades. This need to consider policy tradeoffs is clearly consistent with the MPC's remit, which notes: "*In exceptional circumstances, shocks to the economy may be particularly large or the effects of shocks may persist over an extended period, or both. In such circumstances, the Monetary Policy Committee is likely to be faced with more significant trade-offs* *between the speed with which it aims to bring inflation back to the target and the consideration that should be placed on the variability of output*." I support the MPC's decision to loosen policy at the August meeting, given the prospective tradeoff. If the UK faces renewed bouts of heightened uncertainty and currency weakness, the MPC may in the next year or two face an even greater tradeoff between output volatility and the speed with which it aims to bring inflation back to the target. Clearly any such trade-offs need to be carefully thought through and clearly explained.

Communication

The MPC face two main communications challenges at present.

The first is to ensure that the conditionality of any nearterm guidance on the interest rate outlook (eg as in the August and September Monetary Policy Statements) is fully appreciated. This seems to have been reasonably successful recently, in that market interest rate expectations have moved up and down in line with data surprises. But it needs to be constantly stressed.

The second is to communicate effectively the nature of the policy trade-off currently facing the UK (discussed above) in order to try to ensure that longterm inflation expectations across the economy do not rise materially if (in line with the August IR forecast) currency effects do lift CPI inflation above the 2% target over the next 2-3 years. There appears to have been a rise in inflation uncertainty in the last year or two, with more people replying "don't know" when asked about the UK's likely future inflation rates. This creates the risk that inflation expectations will become more adaptive, tracking wherever the actual inflation rate happens to be, rather than the target. Such an outcome would probably make it harder and more costly (in terms of volatility in output and interest rates) to keep inflation close to target over time. It is important to stress that the MPC is not retreating from its commitment to keep inflation around 2% over time, and will set policy to try to ensure that inflation returns to the 2% target once that temporary currency effect fades.

Policy tools

The MPC has recently further extended its range of policy tools, with the Term Funding Scheme and purchases of sterling corporate bonds for monetary policy purposes, while also expanding gilt purchases and cutting Bank Rate to a new low. Simulations using BoE models suggest that the MPC's current tool kit is probably enough to cope with a "normal" UK recession (ie one in line with the median recession of the last 60 years), in the sense of providing a sufficient stimulus to reverse the downturn and return inflation close to target over time.

But the costs and benefits of these tools need to be kept under review, including in particular whether the QE-induced drop in gilt yields has adverse effects on the economy via higher pension deficits that outweigh the effective stimulus provided. I do not think we are at such a tipping point so far, but this issue needs monitoring. Moreover, it is conceivable that the MPC may need to extend the monetary policy tool kit further in order to achieve its remit if the economy is hit by a truly massive global downturn. The possible costs and benefits of any such measures would need to be carefully monitored, and the rationale for any such moves would clearly also need to be fully explained to the public, markets and the TSC. The BoE so far judges that the adverse effects of a negative policy rate outweigh the potential gains from stimulus, but this issue also needs to be kept under review, especially in light of the experience of other central banks. The MPC has enough tools to tighten policy if needed.

7. Which do you think are currently the most significant risks to the outlook for the UK economy?

Of course, there are always upside and downside risks to growth and inflation that could affect the interest rate outlook. But the key risks currently probably concern the framework for the UK's global trade relations, regulatory structure and economic openness after EU exit, and the effects on the UK's economy, financial system and political stability of the adjustment to that new settlement.

Over the last 35 years or so, the UK economy has become much more globalised, open and flexible in terms of migration, trade, pricing, FDI, financial flows and other channels. EU membership has been an important element in that. In general, these trends have affected both the demand-side and supply-side of the economy. The net effect probably has been positive for economic growth and potential growth in the UK economy (but not necessarily for every region or industry), while also making the UK more exposed to global developments. The extent to which this will change with EU exit is currently highly uncertain. One can imagine scenarios under which EU exit is part of a broader retreat from economic openness and flexibility, leading to substantial adverse effects on economic growth (and potential growth). But there are also scenarios under which EU exit does not greatly affect the UK's economic openness (or, because of other policy measures, the economy's flexibility even increases).

The adjustment in the economy to the post-EU framework could be bumpy, especially if that framework is likely to lead to much lower potential growth than recent trends (which might well trigger substantial renewed sterling depreciation). If such a scenario were to materialise then, provided inflation expectations and pay growth remain well-contained, I would expect the MPC to largely look through any such direct effects on inflation of sterling weakness, even if they extend for several years. But the dilemma facing the MPC - and risks for the economy - would be much sharper if inflation expectations and pay growth were to pick up significantly, potentially requiring the MPC to tighten policy even amidst economic weakness in order to re-anchor inflation expectations.

But there are also other risks, not necessarily relating to EU exit. One in particular is the possibility of subdued growth with increasing imbalances (eg buoyant credit growth, strong house price gains, a clear pickup in household borrowing growth, and large private sector dis-saving). In this case, the MPC might face a dilemma between the case for continued low interest rates (or even a further easing) to prevent the re-emergence of slack, and concern that such a policy stance would fuel dangerous imbalances and excess leverage that cannot be fully addressed by FPC action. The experience of recent decades makes it clear that episodes of rapid debt growth can subsequently destabilize the UK economy. The MPC’s remit makes explicit provision for the MPC to allow inflation to deviate from the target temporarily to support the FPC’s actions in addressing financial stability risks, but so far this issue has not really arisen. In this scenario, it could be appropriate for the MPC to decide to tolerate the prospect of below-target inflation in order to limit imbalances. Of course, any such action would need to be clearly explained to the public, markets and the TSC.

8. What is your assessment of the effectiveness of the policy of quantitative easing in the UK? What, in your view, are the principal challenges of unwinding quantitative easing?

QE has been helpful in providing modest extra stimulus to the UK over recent years, chiefly via the portfolio balance channel and higher asset prices (see BoE Working Paper 542, August 2015). Without QE, the chances are the UK would have had lower growth in recent years and higher unemployment now (taking all other policies as given).

Some of the boost to activity from lower gilt yields may have been offset by the effect of lower gilt yields in expanding deficits of DB pension schemes (see, for example, the BoE Agents report of June 2013 and the QB article of Q3 2012). However, while the rise in DB deficits may be a problem for some individual companies, so far it is hard to see clear evidence that it has seriously damaged the overall economy. For example, despite higher pension deficits, the ratio of business investment to GDP (real terms) is above the 2001-07 average, while the share of the 16-64 year old population in work is at a record high. Moreover, so far this year (and since the EU referendum vote) the share price performance of companies in the FT All Share index with large pension deficits has been similar to the performance of companies without large pension deficits. But, with gilt yields having recently fallen substantially further (and pension deficits correspondingly higher) this is an issue that needs to be kept under review.

The principal challenges in unwinding QE fall into two parts: (a) when and how rapidly to proceed. A decision to unwind QE would represent a tightening of monetary policy and it may well be hard to calibrate the appropriate pace of QE unwind given the possibility that the economic effects of QE are not constant over time. For example, the BoE study referred to above concludes that QE1 (£200bn during 2009-10) was more powerful on a like-for-like basis than QE2 (£175bn during 2011-12). The market reaction to the August 2016 easing was relatively large, hinting at expanded sensitivity to QE, although this may also reflect the other measures announced at the same time. It may well be that the best strategy is initially to unwind QE slowly, to obtain more information on its effects, but this would be a decision taken at the time. (b) to manage the interaction between the resultant drop in bank's reserves at the BoE and the Sterling Monetary Framework that aims to anchor overnight rates close to Bank Rate. The expansion of QE lifted bank reserves and the unwinding of QE would (unless offset by other BoE actions) tend to reduce bank reserves one for one. If the SMF has returned to some form of reserves averaging scheme (as in the period before 2009) then presumably there would need to be some interplay between the drain on reserves from unwinding QE, the aggregate reserve targets of the banks, and other BoE money market operations that affect the aggregate level of reserves. This is a technical challenge that should be achievable with preparation.

9. Are there circumstances in which you might tolerate higher or lower than target inflation for wider economic reasons?

Yes. The remit explicitly allows the MPC to tolerate deviations of inflation from target in response to temporary shocks, or where attempts to keep inflation on target may "*exacerbate the development of imbalances*" that the FPC judges may represent a threat to financial stability or, "*in exceptional circumstances*" where the economy has been hit by a major or persistent shock such that an attempt to return inflation to target over the usual 2-3 year horizon may have unduly destabilising effects on the economy. This flexibility is useful.

The MPC has frequently made use of the "*temporary shocks*" clause. After the EU referendum vote, the Committee now is faced with a greater need to consider the appropriate policy tradeoffs between output variability and the inflation outlook. As discussed above, the EU referendum vote seems likely to trigger a combination of somewhat lower growth and (allowing for referendum-induced currency depreciation) higher inflation over the next 2-3 years. Under these conditions, the Committee judged in August that a policy aimed at keeping the 2-3 year ahead inflation forecast at the 2% target would have undesirable effects in terms of weaker output nearterm and risks of a renewed inflation undershoot further ahead. As a result, the Committee loosened policy, even while the central forecast was for inflation to exceed the 2% target 2-3 years ahead. I agree with that decision.

The financial stability clause has not yet been the dominating factor in monetary policy decisions, but could yet become so. The experience of the last 30 years highlights that destabilizing cycles in the economy – which subsequently make it much harder for the MPC to keep inflation on target -- can often show up in asset prices and credit growth well before they affect inflation. The remit sensibly encourages the MPC to be alert to such risks.

10. How important do you think it is for MPC members to be subject to parliamentary accountability? What do you think are the strongest and weakest parts of MPC accountability?

I believe individual accountability of MPC members to Parliament through the TSC is very important, partly to ensure appropriate scrutiny of policy decisions and the policy framework, and also as a safeguard against any attempt to pack the MPC with political appointees to bias monetary policy decisions (something that has not occurred yet). The TSC confirmation hearings are a crucial component of that accountability. Indeed, I contributed evidence in favour of confirmation hearings to the original TSC enquiry into the issue in the late 1990s (the TSC report was published as Hc282 in October 1997).

The strongest part of accountability is the requirement that all MPC members appear before the TSC for a confirmation hearing and also appear subsequently before the TSC on a regular basis. The TSC seems now to have greater research resources than previously to underpin its work and ensure a more thorough grilling of witnesses, which is welcome.

The hardest part of accountability is the distinction between ex ante and ex post accountability. MPC members can validly be judged on whether their decisions and analysis of the economy and risks (based on information available at the time) were reasonable in light of the remit. Given the likelihood of unexpected shocks, MPC members should not be judged solely on whether inflation outturns over any period are exactly in line with the target.

It seems to me that the weakest part of accountability is that the TSC can probably only judge the publicly-visible contribution of MPC members (eg speeches, written articles, TSC testimony) and is probably less able to judge the less-visible role that individual MPC members play in contributing to the MPC's collective debate over the economic outlook and policy decisions. This latter role is, however, a crucial aspect of the effectiveness of individual MPC members and of the Committee as a whole.

11. What activities do you intend to undertake in order to add to the public's understanding of the role and decisions of the MPC?

I believe it is very useful for MPC members to have wide exposure outside the BoE, with a two-way flow of information. Monetary policy is likely to be most effective if the MPC's aims and decisions are widely understood. And, at the same time, meetings with external contacts, researchers, and businesses can help keep me up to date with developments in the UK and global economy, which sometimes do not show up quickly in official data. Hence, I expect to speak regularly at public events outside the BoE, to publish speeches or articles, and to seek a wide range of external contacts.

12. How do you think the MPC can avoid groupthink? How do you intend to maintain and publically express an independent voice?

Groupthink is a regular problem in many organisations. The rotation of external members into the BoE is a helpful corrective, but the issue always needs to be watched. I intend to do my own analysis and forecasts of the UK economy, as I have done for over 25 years, while of course working closely with MPC and BoE colleagues. As noted elsewhere, I expect to make regular speeches and public comments on the economic outlook and risks, and would be happy to appear before the TSC as often as you like.

13. Do you believe that there is merit in having individual paragraphs in the minutes of MPC decisions in which members can explain their votes?

I do think it is useful for all individual MPC members to regularly describe their own personal views on the outlook and risks, and any issues on which their personal view is significantly different to the MPC consensus. This has advantages for the accountability of individual MPC members, to avoid "group-think", and may usefully highlight areas of uncertainty that can help draw in outside experts. At present, this occurs through the individual MPC members' Annual Report to the TSC and, sometimes, through the speeches of individual MPC members. I am open-minded as to whether such individual statements should come in the minutes for each MPC meeting, or perhaps only at minutes of Inflation Report meetings, or via speeches of individual MPC members.

One potential disadvantage of putting such a statement in the minutes of each MPC meeting is that the minutes may cease to be a representation of the debate among MPC members and more a collection of statements by individual MPC members. The Swedish Riksbank does this approach and I personally find their minutes less useful as a result. In particular, it can be harder to sort out which differences of opinion are minor and which are more substantial. Nevertheless, I would like to see if there is scope to do more than at present.

14. Do you think the minutes of MPC meetings should attribute opinions raised in MPC meetings to individual members?

No, because I believe this would just make the minutes cumbersome and inhibit debate. I expect that, in debate, MPC members will sometimes find it useful to play devil's advocate, to test arguments even if they do not fully support them. This might be less likely to happen if opinions are always attributed to individual members.

15. How do you think your work will interact with the work of the FPC?

The MPC and FPC have regular joint meetings four times per year to assist cooperation. As noted above, trends in asset prices, balance sheets, money and credit growth have frequently given early warnings of broader threats to economic stability (and hence, subsequently, to the MPC 's ability to keep inflation on target) even while CPI inflation trends have, on the surface, been reasonably benign. Examples are the late 1980s boom, the late 1990s boom and the 2003-06 period. As a result, I suspect that both the FPC and MPC will have a close and common interest in these areas. The FPC is the first line of defence against financial stability risks, but there are circumstances under which the MPC might need to act to support the FPC. The MPC also need to understand the impact that any FPC decisions could have on the wider economy.

In the event of a vote to leave in the referendum, please answer this additional question

16. What do you think the consequences of a vote to leave the EU will be on:

A) The economy.

In line with the views of the OECD and IMF, I currently judge that the most likely outcome is that EU exit will result in slightly lower potential growth in the long term, reflecting the UK's reduced trade access to EU markets, drop in inward FDI, lower inward migration, the need to reallocate resources away from high value-added sectors (eg financial and business services) to other sectors with lower value-added, and the adverse effects on capital stock growth of increased uncertainty. But these effects are uncertain in scale and timing, especially given that the framework for the UK's global trade relations after EU exit is as yet unknown. In addition, EU exit may be accompanied by other policy changes that reinforce or offset these effects. As discussed earlier, these effects on potential growth are longterm in nature, and may come through quite slowly for an extended period. The extent to which these longrun effects feed into the near-term outlook is highly uncertain and, as discussed earlier, I am somewhat more optimistic about the growth outlook than the consensus for the next year or so.

B) Inflation and monetary policy decision making.

The potential effects of Brexit on inflation come through two channels: will demand weaken more than supply? And how much will sterling's recent depreciation (triggered in part by the Brexit vote) lift inflation via imported costs? On the first issue, as discussed above, I suspect that the dampening effect on demand probably slightly outweighs the effects on potential growth, because of the adverse effects of heightened uncertainty, especially on business investment. But, this is not a given and it is conceivable that Brexit will affect the demand- and supply-sides of the economy more or less equally in the next few years, especially if one considers the recent monetary easing and depreciation in sterling as part of the effects of Brexit. Moreover, any slowdown in demand relative to supply must be set against the starting point that economic growth probably recently has been slightly outpacing potential growth, evident for example in the continued decline in unemployment. Hence, even with a slowdown in growth, I currently doubt that slack across the economy will rise significantly in the year ahead.

With the added boost to inflation (and growth) from recent sterling weakness, the overall effect of EU exit on CPI inflation over the next 2-3 years is likely to be upwards. The persistence of any such inflation blip would depend in particular on whether there is a knock-on boost to inflation expectations and pay growth.

As discussed above, the vote for Brexit probably will trigger a period of somewhat lower growth and higher inflation. This is likely to require the MPC to put greater weight than usual on considering the appropriate tradeoffs between the speed with which the Committee seeks to return inflation to target and the variability of output. In this regard, I would expect the MPC to tolerate a modest currency-driven inflation overshoot in the next 2-3 years, provided inflation expectations and domestic cost growth are reasonably well-contained such that inflation is likely to return to the 2% target further ahead. This is fully consistent with the MPC's remit. The need to consider, and explain, such policy tradeoffs between inflation and output variability may well become greater if, as is possible, there are renewed bouts of Brexit-related uncertainty and sterling weakness.

C) Sterling

The likely need to rebalance the economy away from EU-centered trade, especially in financial and business services, probably requires a weaker pound to expand other tradable sectors (notably manufacturing). A substantial drop in sterling has already occurred this year, both before and immediately after the EU referendum. Given the scale and persistence of the UK's current account deficit, I would not be surprised if sterling falls further, but I am fairly agnostic as to whether any further depreciation is likely.