BANK OF ENGLAND

UK economy: grounds for hope

Article by

Ian McCafferty, External Member of the Monetary Policy Committee, Bank of England

Published in the Daily Mail on 29 April 2013

Last week we saw the first estimates of economic output for early 2013. Growth was a little stronger than had been expected, dispelling fears of recession. Looking forward I see grounds for hope. Some of the forces that have held back recovery are easing. Supportive policies from the Bank of England are having an effect. Confidence is creeping up.

When the Monetary Policy Committee at the Bank of England meets each month, we pore over the recent statistics to assess how the economy is doing. The latest GDP figures suggest that it grew, modestly, in the first quarter.

In my view, for some time the economy has been healthier than headline figures suggest. Output can move erratically each quarter as it gets buffeted by events. GDP fell in the second and fourth quarters last year, but that reflected an extended holiday around the Queen's Diamond Jubilee, and a post Olympics dip, rather than a return to recession. And the weakness in GDP was heavily affected by sharp falls in construction and North Sea oil production. The rest of the economy – over 90pc – grew by 1.2pc last year. I do not wish to sound complacent – that still implies a slow and difficult recovery. But it is far from the doom and gloom reports of a semi-permanent recession.

The global financial crisis has left three problem legacies for Britain. It revealed that some UK banks' balance sheets were in a terrible shape, which has led to significant constraints on bank lending to households and businesses. That is why it has been important for banks' capital levels to be rebuilt. Consumers have focused on saving more and limiting their indebtedness. And the impact of the financial crisis on the public finances meant that fiscal tightening of some sort was inevitable.

The recovery has also been held back by the euro area crisis that has badly damaged confidence here and overseas. And there has been a nasty squeeze on household incomes, driven by the effect of a weaker pound on import prices, the rise in global commodity prices, but more recently higher regulated and administered prices, things like the rise in university tuition fees.

The Monetary Policy Committee has two aims. To ensure that inflation remains under control – set to return to our 2pc target; and subject to that to support growth. Inflation is above our target, and expected to remain so for some time. But domestic inflationary pressures – especially wages – remain very subdued. To help the economic recovery we continue to hold interest rates at very low levels. We have created and injected a substantial amount of money into the economy through our so called quantitative easing programme and that has pushed down longer term interest rates and supported financial asset prices such as bonds and shares. The Funding for Lending Scheme was introduced and has been extended to guarantee cheap funding for banks to lend to companies and households.

Credit conditions are improving, with some signs that lending to households will pick up in coming quarters. An improvement in the housing market, combined with resilient employment, should help to support household spending. I speak with a lot of businesses around the country, and I have been struck by the improvement in their confidence in recent months, as fears of disruption from the euro area crisis have eased. And I see encouraging signs for British exports. World trade is picking up and UK businesses are succeeding in re-orienting their exports to faster growing emerging markets.

There remain some forces holding back the recovery and there is only so much that our policies can achieve. But I think the outlook for growth is looking more encouraging than it has for some time. The future is uncertain, there are risks that may knock us off course and the MPC stands ready to respond. But overall I am cautiously optimistic.