Bank of England

Inflation Report Q&A
12th February 2015

Phil Aldrick, The Times: I just wondered about Greece, and whether a Greece - a dirty exit - would throw all of your forecasts off course and require some - what kind of response would it require, do you think?

Mark Carney: Well, recognising that this is a hypothetical question, you know, would a change in Greece's position have an impact on the forecast? Yes. Would it have the same impact on the UK economy as it would have had in 2012? No. There are differences now than there were in 2012. They include differences to the institutional arrangements in the euro area, both facilities at the level of the euro area, but obviously importantly facilities announced by the ECB - I'm speaking specifically of OMTs, and of course coupled with the demonstrated willingness of the ECB to use its full toolkit, as appropriate, to meet its remit.

There are also differences since 2012 in terms of the track records of the various economies - so-called peripheral economies - within the eurozone. And those differences in track records are certainly reflected in market yields. You've seen yields on 10-year bonds of Ireland, Italy, Spain, Portugal, etc., tighten over the course of the last several months as these issues have risen up the focus of markets, at the same time that obviously Greek spreads have moved further out.

And the third reason why things were different is that the scale of private sector exposure to Greece, both within the euro area and certainly from the UK financial system, has gone down.

And on that last point, just to be clear, I mean, one of the advantages of the structure of the Bank is that we're obviously the prudential supervisor as well as the monetary authority. And so we have direct line of sight into the exposures of our largest financial institutions to Greece. And I can tell you that the level of that exposure is less than 2%

of common equity, and it has been coming down. So I'm speaking specifically about the UK banking system here.

So for all those reasons there's a different order of magnitude. But it would have an impact, and we would have to assess that impact at the time. And, as I said in my opening comments, we do have the means and the will, and obviously the responsibility, to take whatever action is necessary in any eventuality, in order to bring inflation back to target within a reasonable time horizon.

Jennifer Ryan, Bloomberg News: It's a question about your inflation projections. So they're shown as above target at the end of three years, but of course market expectations have changed since then and are now looking for a Q1 rate increase. So can you talk a little bit about what that does to your interest forecast - not your interest rate forecast - your inflation forecast? And, you know, does that mean that at the end of the period they should be back right down at the target perhaps? And also, what does that mean for what investors are now thinking? Are they actually now spot on?

Mark Carney: Well, as you know, Jennifer, we don't do real time updating of our inflation forecast. The next one's due in the middle of May, I think. Yeah, we get three months to think about these questions, as Ben says.

Look, I think what is safest to say is that, using the curves that we had at the time when we conducted the forecast, which is the time at which we took our policy decision, last week, that you did have that slight overshoot.

Jennifer Ryan, Bloomberg News: So what does that do to where markets ought to be right now? I mean, are they wrong?

Mark Carney: Look - markets will - I think - let me go back to something I said at my opening remarks, which is that what markets have

been doing since our last forecast in November is they adjusted their expectations around the pace and degree of rate increases, in an environment of some additional external headwinds particularly to growth. So they adjusted them down, and notably so. And I would suggest that they did that because the market understands in general what the MPC is trying to do.

What we have with today's Report and accompanying letter is as much clarity as we can give about what our objective is. So we're being very clear that we think that we should be returning inflation - given the nature of the shocks that have hit the economy, and given that most of the shocks that have affected inflation have been one-off price level shocks - these big commodity price shocks, we've been clear that we're going to look through those. And given the absence of a trade-off between output or employment and inflation, the absence of that trade-off, that we should return inflation to target as quickly as possible. And our judgement is, given all that, within the next two years.

The market can take that information, can take other developments, and make its own judgement about the exact pace of those. And we won't provide a real time running commentary on that, except I just - I think I should underscore the point that what is consistent with our objective, our stated objective of returning inflation within the next two years, it is - it does require some limited and gradual increases in interest rates over the forecast horizon.

Richard Edgar, ITV News: Perhaps, trying to make your comments slightly more concrete. In your letter to the Chancellor, you refer to falling prices and the action that you could take if deflation were to set in. Should borrowers and savers be preparing then for a rate cut, as we've seen today in Sweden, or a rate rise?

Mark Carney: Well, I think it's pretty clear, in terms of our central expectation, that the most likely next move in monetary policy is an increase in interest rates. As we've been saying for some time, we expect those adjustments to be limited and at a gradual pace, but the message is clear: in order to achieve our objective, we're going to look through this one-time adjustment - which in the end is good news, by and large, for British households, recognising there are some distributional impacts across the United Kingdom, but it's good news for British households.

And we're going to look through that and ensure that inflation comes back to target in a timely fashion. But that is consistent with some rate increases over the forecast horizon, in our judgement.

Estelle Shirbon, Reuters News: The pound hit its highest level against the euro in seven years on Wednesday. I was wondering how much of a concern that is for the Bank.

Mark Carney: Well, speaking from an inflation perspective, one of the drags on inflation at present has been the impact of past depreciation of sterling, not just against the Euro but against a host of other currencies - Yen and others - particularly emerging market currencies.

We're seeing that pass through also help dampen inflation. It's not the most important factor, but it's also helping dampen inflation right now. So it's something that we do monitor. But, as I said before, our judgement is that, given all those factors, given the shocks that have hit the UK at present, we can chart a course which delivers inflation back to target within an appropriate horizon.

Robert Peston, BBC: Good morning, Governor. You say that the months you expect of zero inflation and the probability that it'll turn negative is basically a good thing, that it reflects oil price

cuts, food price falls that are putting money into people's pockets - spending power, augmented spending power for shoppers. How would you know, how would you judge, however, that good price falls were turning into bad deflation? And if you were to judge that good price falls were turning into pernicious deflation, what would you then do about it?

Mark Carney: Right. Well, it's an important question, and we would distinguish what's happening at present and what's likely to happen over the course of the year from a - as you say - a bad deflation outcome. This is - we've had a dramatic change in a series of commodity prices, most notable oil - the biggest move - the third biggest move in the last half-century. And that's flowing through to the petrol pump.

That is different than persistent and widespread falls in prices. So one of the things that we look at, and will continue to look at, is all the components of the CPI - which of them are falling? What is it relative to historic averages?

And in the letter, actually, we draw attention to this. It's - I think the figure precisely is about 68% of the components are rising - the components of CPI are rising.

Robert Peston, BBC: [inaudible]

Mark Carney: But they are rising, because obviously oil and food are rising - I'm giving you the components that are actually increasing within the CPI. That's bang on historic averages. So in other words, we're seeing more concentrated falls in prices. So there's nothing particularly unusual about the breadth of the change in prices. And that's very important. So the first element of your question is - what are we going to look at? Well, we'll continue to look at the breadth of changes in prices; look at the persistence there, but obviously monitor inflation expectations very closely. And we do; as detailed in

the Report, inflation expectations are consistent with the 2% target. We list all the ones that we look at - more than half are in line with historic averages, but again, we will watch that - watch that closely. We'll also watch developments on the wage front as well, to the extent that wage patterns start to be affected.

I think the important point, which is entirely from a contingency or risk management perspective, is to underscore that, if we were in a situation (which we are not in at the moment), but if we ever were in a situation where we needed to provide additional stimulus, we have many options - we have many options to provide that stimulus, and the effectiveness of the stimulus is reinforced by the relative health of the financial system as well.

But just to bring it back to where we are today, we see these one-off changes in prices. Good news. Helps support real incomes - we expect the strongest real income growth in over a decade actually. And as a consequence of that and other factors, our view is that the most likely moves on monetary policy are rate increases.

Bill Keegan, Observer: I wondered, Governor, whether you've had any reaction from Berlin, Brussels or Frankfurt to the points you made in your Dublin speech about the fiscal deficiencies of the eurozone?

Mark Carney: The issues in that speech - the true answer is yes - and the issues in that speech around - let me generalise it first and I'll get to the specifics, which is the importance of building greater private and public risk sharing in the eurozone. So banking union, capital markets union, absolutely essential, but also some element of public risk sharing related to fiscal arrangements, just as we have here in the United Kingdom - as virtually any currency union has.

Those issues have been discussed in the past. Those issues were publicly aired in the report of the four presidents a few years ago. And I have had discussions with my counterparts both prior to the speech and subsequent to the speech, both in central banks and ministries, on these issues.

These are medium term issues; they're not conjunctural issues - it's not about short-term stance of policy, but it's about structuring a viable currency union. I mean, I will say - and if I can bring this back to - and I would say there's a much more general recognition of these issues than one might expect.

If I can bring it back the UK. Again, speaking from a structural perspective, one of the reasons why the fall in oil prices is unambiguously good for the UK economy, even though there are distributional consequences - there's impacts in Aberdeen, there's impacts in a series of businesses that support the energy sector - is because we have longer-term fiscal arrangements. And those structural fiscal arrangements have the impact - and it's referenced in the Dublin speech - that the impact on fiscal capacity in Scotland, for example, is only one tenth of what it would have been in their absence.

And that's one way that the benefits of lower oil are recycled through this economy, which helps smooth the adjustment.

Inaudible question

Mark Carney: The issues are well appreciated, I would say. No, I mean, I think it's an issue in terms of understanding the economics of the issue. The question is the timeline and the mechanics of addressing it.

Larry Elliott, the Guardian: One thing that recent history has told us is that the Bank's forecasts are unlikely to pan out exactly the way you expect

them to. And you say that the risks around them are broadly balanced. I just wondered whether you could explore that a bit more, because one option here - one risk - would be that we have something similar to what happened after the 1985/86 fall in oil prices, that there was a very big increase in consumption in the UK. Low borrowing costs set off much higher growth than people imagined. That's one risk.

The other risk is that the dynamics that have kept inflation falling, the underlying reasons for it - low wage increases, lots of slack in the labour market - that that continues, which has really been the more recent history, that throughout the last two or three years expectations of when Bank Rate will rise have been pushed further and further backwards.

So I just wonder - do you really think those risks are equally balanced or do you have a hunch which way it's more likely to turn out? Are we likely to see much stronger levels of activity and higher inflation, as it was in the mid to late 1980s, or are we likely to see a continuation of what we've seen in the more recent past?

Mark Carney: Let me say a couple of words, then I'm going to pass to Ben to give his perspective on it.

I think the thing that we have seen in recent months is the start of the turn of wages, and consistent with the change in slack in the labour market. So we've seen the start of that. Now I wouldn't over-play that; it's still relatively early days, and actually I might take an opportunity just to point out that we think there are going to be some base effects that impact the average weekly earnings numbers in the course of the next couple of months. So we may see sequentially a little slowing in that, but on an annual basis we still see - we still expect to see a pick-up.

That provides some balance to that downside risk. That’s the first point I'd like to make. The second is that what's important is that it's recognised that we will fulfil our responsibilities, by which I mean we're going to have a period where headline inflation is low - very low - for most of this year, and that's a good thing in general because of the causes of it. It's not a good thing if it persists, though, because a little bit of inflation greases the wheels of the economy, as you know. And so the recognition that we're going to be responsible in the calibration of policy, so that inflation comes back to target. But that feeds into expectations of employers and of workers in setting wages and in planning investments.

But I might ask Ben to say a bit broader about how we construct risks and how we think about this.

Ben Broadbent: Thanks. Well you're right to highlight the risks and that's why we have Fan Charts and not just point forecasts and we continually make an effort to remind people of that. And you can judge from the width of those the sort of scale of the risks we're talking about.

One thing I would say though, with reference to your comparison with the 1980s, is that of course the policy regime, and specifically the monetary policy regime is very, very different. And throughout that era, throughout the '70s, and the '80s actually, inflation was far more volatile than it is now. I mean, if we'd drawn a Fan Chart then without an inflation target I think it would have been a lot wider.

Now that improvement was flattered probably by the years of the great stability. My predecessor predicted at the beginning of - when the Bank was first granted independence over monetary policy that we'd be writing a letter 40% of the time. So things got even better than that, probably not for reasons, or at least solely for reasons to do with the improvement in

monetary policy. But I don't think that the '80s are a relevant comparison for the sort of scale of the risks to inflation we're talking about.

Chris Giles, Financial Times: It's a question either for the Governor or maybe Minouche. Interest rate futures markets have moved very, very rapidly in the last few days from a position far away from the Inflation Report, to one which is almost entirely in line with the Inflation Report. Are you worried that you might have had some data security breaches of this Inflation Report such that the forecast might have leaked out to the markets and what might you do about that?

Mark Carney: Well I can take that, I have absolutely no reason to have those worries. There's been adjustments - there's always adjustments in markets in terms of expectations of stance of policy. And one of the things, as you know, Chris, is that our future, our forward OIS curve, is quite flat and so relatively modest moves can translate into relatively large moves in calendar space. So you can move easily from the fall of 2016 to the spring of 2016 with relatively small moves.

But look, no, we have - you know you have the joy of being locked up here when we release various documents. We have very robust security procedures and I have absolutely no reason to credit that concern.

Helia Ebrahimi, CNBC: A bit more on wages, do you think it's irrelevant now to call for companies to raise people's wages, given you're forecasting that household incomes rates grow at their fastest pace in a decade, or is there a real risk still of deflationary pressures becoming entrenched until we see real wage rises?

Mark Carney: Well I think - this is a risk we're looking to guard against. And I think I would say that this is a strength of this system is that, given how low inflation, is there's a need to write a letter to explain why that's there and what we're going to do

about it, and provide as much clarity as possible. And that should help inform wage setting. And you know - and I think the message is we're quite comfortable in giving message of our ability to bring inflation back to target in a timely fashion.

In terms of the dynamics of the labour market, it continues to tighten broadly as we had expected, so slack has - our estimate of slack has come down to the region of a half a percent. We are seeing, as I referenced earlier, and we reference in the Report, tangible increases in wages. It's still relatively early days. The survey measures support that as well; our agent discussions support that as well. And by having an opportunity to make clear that there is a good element to these falls in prices, the falls in commodity prices, and that that will reinforce, in our expectation, consumer spending. That should help support a well-functioning labour market. So we're not making an appeal to companies in order to do something, we're just observing what we expect is most likely to happen.

David Smith, Sunday Times: It's a very similar point, but I noticed in the last MPC minutes there was a concern that pay settlements would follow inflation down and you'll be watching that closely.

Mark Carney: Yes.

David Smith, Sunday Times: In this Report you've revised up your predictions for average earnings growth, which presumably is on a basis of unemployment coming down more quickly. But that's still alongside fairly weak productivity growth, certainly for this year and not particularly strong in future years. Do you think that's a rather bold forecast on earnings growth, given where we are now and where we've been in the last few years?

Mark Carney: Yeah, well - I'll invite Ben to amplify, but I think we're quite comfortable with the central expectation of that forecast given the tightening in the labour market. As you know, the

dynamics of consumer spending are reinforced obviously by the improvement in real incomes that comes from the changes - the temporary changes in prices. And that we are conscious of the risk that there could be persistence in lower wages, you know, just this long period of relatively weak earnings growth could have an element of persistence which could delay this adjustment, and that's one of the downside risks.

And to be clear again, to map the risks, and then I will ask Ben to amplify. In our famous Fan Chart of the inflation forecast we do have a slight skew in the next year - downside skew in the next year - just because of the possibility that there could be a little more persistence once prices are low, that it could just extend for a little longer. But we think that comes away within the two-year horizon.

Ben Broadbent: The only thing I'd add is just to highlight the importance of, as you have yourself, of the productivity growth forecast on which all this depends. We wouldn't view that in the longer-term comparison as unduly optimistic. We have it improving, but we have that rate of growth only just getting back, by the end of the forecast, to the average of the pre-crisis growth rates.

So yes, it's faster than we've seen in the three or four years since the crisis and therefore earnings growth is also faster. But I think, viewed on the long term perspective, I wouldn't say it's overly optimistic.

Ben Chu, The Independent: Governor, a question about the risks posed by household balance sheets. Other forecasters, not least the Office for Budget Responsibility, have projected a very large increase in the level of household leverage and a sharp decline in the savings ratio. I'm just wondering what your view is of those developments. Do they pose a risk that people become overleveraged? You do project an increase in consumer

spending; how worried are you about unsecured lending, etc., increasing?

Mark Carney: Well, I think I would speak more broadly for the Bank, including the FPC, that we continue to monitor quite closely developments in household balance sheets. And we view, you know, when we viewed the risks around the housing market it was through the lens of household balance sheets in the medium term as being the biggest medium-term risk to the UK economy, and that remains the case.

I would observe though that there has been improvement in household balance sheets. British households have paid down about 20 percentage points of debt to income. That ratio is still above its longer-term average, but it has been coming down. The savings - because of the growth in wages, the combination of growth in wages and lower inflation in the near term, actually, even though we have a fairly robust outlook for consumption, the savings rate holds up in this forecast. So this is not a debt-fuelled expansion in our forecast; it is something we watch.

I'd make a last point which is a general one, which is that the UK as a whole, while it was quite over-levered obviously into the crisis, the UK as a whole - the private non-financial sector, so households and corporates have actually been one of the only sectors that have - internationally - that have de-levered and the combination of the two has been in the order of 30 percentage points of GDP. So there's been a fairly notable deleveraging; so there's progress there. But the motivation for your question is still spot on; we do see these issues across the Bank as the most important over the medium term.

Louise Cooper, Freelance: I also want to ask about inflation. If you look at the scale of your cuts to the inflation forecast, it's really been quite dramatic. On the outside chance on your Fan Charts, you do

predict potentially a minus 2% inflation figure on Chart 5.13, Page 49. And also on Page 33 there's a Chart A, the impact of a fall in oil prices on inflation will be short-lived, but that assumes a 10% fall in oil prices. Actually what oil prices have done, as we all know, they've halved and the scale and the size of that fall has been almost unprecedented. What are your forecasts for the oil price going forward and how does that feed into your inflation forecasts?

Mark Carney: The first thing is that yeah, there's a large move relative to November. Four fifths of that move, relative to November, is accounting for the fall in the oil price between when we did the November Report and when we did this Report. I'll just remind - I think you know this, Louise, but this Report gets locked down when we make the decision, which was last week, and oil prices at the time of that decision. So from a spot perspective - and we use spot oil and then we use the futures curve, because it's a neutral assumption. It's not a fantastic predictor of future oil prices; the spot is arguably the best, but we're not going to get into the business of forecasting the oil price. So we use the futures curve.

That futures curve, for what it's worth, and it's going to keep moving around I'm sure, but that futures curve since last week and today has moved up fairly substantially. And so if we were to use today's futures curve as opposed to then, you would see that Fan coming up.

We did the rule - you know gave some sensitivities in terms of the impact of change in the oil price on UK growth, so that people can do their own analysis around it and the immediate pass-through to inflation because oil is going to move around. And because oil is going to move around, I think it just reinforces the point - if I can make a policy point - it reinforces the point that we're not going to swing around monetary policy to try to chase oil, not just because it's

volatile, but also because the lags on monetary policy are such that it would not have the effect that we intended.

Louise Cooper, Freelance: But how much of a risk do you think a lower oil price poses to your inflation forecasts?

Mark Carney: Well I think the - I wouldn't put it in the - in terms of the actual inflation outcome, it will be affected by big swings in crude prices. You know, if we have another 50% swing in crude prices, yeah, that will have a notable impact on the inflation forecast.

The issue, the fundamental issue in terms of the functioning of the economy is - does that generalise, does that pass through to broader prices? Does that pass through to people's expectations of inflation? And again, I'm slightly repeating myself, but the advantage of the system that is here is that we have opportunities, not just through the Inflation Report, but also through the letter writing process, to explain why inflation has moved, what we're going to do about it, and over what time horizon, so that people's expectations can be informed by that.

Richard Barley, Wall Street Journal: Governor, a number of central banks have cut rates into negative territory, Sweden most recently this morning, and bond yields are negative in a number of European markets. The Bank highlights that, were it necessary, it now thinks it could cut rates from 0.5. Has the concept of a lower bound for rates been scrapped? And what are the risks around these unusual negative rates and negative yields?

Mark Carney: Well I think - thank you for the question. I think the different countries, different jurisdictions, have different financial systems, different arrangements and therefore will have different concepts of the lower bound. And I'm going to ask Minouche to add to this.

The relevant factors in the UK and the sort of limiting factor in the UK had been previously the relative strength of the banking system and the building societies, the capital position of those. And given the asset liability mix of those institutions, what impact would an even lower Bank Rate than 50 basis points have on their ability to rebuild capital?

Now as you know, we've made a lot of progress, and those institutions have made a lot of progress in rebuilding capital. So because we had to write the letter, because we had to explain all the contingencies and the various risks in the context of the letter, and because just naturally we continually update our thinking on what we could do if we have to ease, whether it's on the asset purchase side, or with respect to Bank Rate, we provided an updated view on that.

I'm going to ask Minouche to say a word on market functioning, but I will say just a general point which is, there is still a lower bound in these other jurisdictions; it's a question of exactly where it is, and they're taking an assessment. At some point holding cash makes sense relative to using the system, but I don't know if you want to talk about …

Minouche Shafik: I think as the Governor said there are two main risks of going negative. One is the risk of people reverting to cash - both financial institutions and households - and also the worry about what happens to money markets when rates are negative. So there's a little bit of a time limit as to how long, we don't know how long until it becomes desirable for people to go into cash. But I think, as the Governor said earlier, we're not there yet, so we have the advantage of observing what happens in those several countries now that have negative interest rates, to see what the consequences are for those two issues.

Harry Daniels, Live Squawk: Just a question really on central banks and getting the message across. Do you believe central bank credibility should be sacrificed for monetary policy goals? I refer to the Swiss National Bank and their recent moves last month - and how you balance the two: your monetary policy goals and credibility after, you know, what we saw in the "black swan" event there?

Mark Carney: Well I think, and all colleagues would agree, that our credibility is essential to consistently meet monetary policy goals. And the way we can most effectively reinforce that credibility - and it's a constant task to continue to reinforce and add to that credibility - the way we can best do that is to be clear about exactly what we're trying to accomplish. Again, that's the advantage of this process. It's not just the 2% inflation target but it's over what horizon, given the shocks that are hitting the economy, and how we're going to go about achieving that.

And then, amongst many other things, providing as transparent and complete analysis as possible and finally answering questions around that, both from you, from market participants, from businesses and from households, to explain that.

And the last element which I would add is something that we've been trying to do at the Bank, and this is based on recommendations of Stockton and others, but is to go back and assess where our forecasts have turned out to be wrong or not consistent with what actually transpired, why that was the case, why those errors were there, and if there are any broader lessons to be learnt from that.

Jenny Scott: Sorry, we've got quite a few other people to get through. Hugo.

Hugo Duncan, Daily Mail: Governor, how concerned are you and the MPC about the balance of the recovery? You've obviously raised your household consumption forecasts but trimmed export forecasts and cut quite heavily your business investment forecasts. And on the latter, how concerned are you about uncertainty surrounding the general election, British politics, this year on business investment and possibly the wider economy?

Mark Carney: Right, start with the general concerns about the balance of the recovery. It is not having an impact at this stage on the stance of monetary policy. It is something we discuss, something we track. There is - our consumption forecast is obviously supported, as I've said, both by our outlook for wages but also the dividend, if you will, in the short term from lower energy prices.

In terms of the investment forecast, I'll make a specific point and then general. Near term investment, most of the adjustment to near term investment is because of lower expected investment in the North Sea, so it’s notable and you picked it up. And it’s not an adjustment because of change in broad investment intentions, which gets to the last bit of your question which is around uncertainty, whether it’s geopolitical, European or domestic. We, like our agents, our discussions are picking up elements of domestic uncertainty, as are the CBI surveys, as are the British Chamber of Commerce surveys as well. What we haven’t seen is that yet being translated into changes in investment plans, and we certainly haven’t seen it affecting actual investment in real time. So the forward investment intentions are at this stage holding out even though there has been a pickup in observation about uncertainty in general, including domestic elements of it.

Henry Curr, The Economist: Does the case for looking through the effects of the oil price fall hinge on the fact that that’s unanticipated or that it’s

external? Let's say that the futures curve did show an oil price change which you were able to offset because it was sufficiently far in the future, would you happily steer domestic demand to offset that or is it domestic inflationary pressure that you really care about?

Mark Carney: Yeah, if only the future curve were that good a predictor. But let me take your hypothetical up a level, if I may, which is that if we could foresee some sort of persistent disinflationary or deflationary force that we had quite a high probability that that was going to keep us off target, all other things being equal, and that that were going to persist you know beyond the usual horizon of two years, three years and beyond. And an example of that might have been the impact of, you know, Chinese - I'll simplify it to Chinese manufacturing at the turn of the millennium - one could have foreseen that. Given our remit, given our mandate, should we lean against that in order to achieve the inflation target? Yes is the short answer, given that we have operational independence, a clear remit, we would have to explain why we're doing that and make it transparent.

In a world where that is a positive supply shock, it's good disinflation. One might want to have a conversation about whether or not that should be kept. Now I'm getting into the hypothetical of the hypothetical, so I should probably just stop. But it's going to be a pretty unique circumstance where one can have a central bank or even The Economist can have the confidence that there is this force that has that impact and it's likely to persist as opposed to being just a shock, so it's enduring. But again, to repeat myself, the short answer, given the remit, is if we knew it and we could lean against it, we would.

Mike Bird, Business Insider: I'm just looking at chart 1.1 as well, the forward rates internationally. One of the interesting things is the fairly sharp change in the intersection between the US and UK

curves. I think if you go back to about summer last year, people were certainly expecting a Bank Rate hike before and the market is now implying a sort of July or so hike from the Fed, a lot longer from the UK. Obviously I won't ask you to comment on the Fed's reaction function, but how would you characterise the differences in the recovery and inflation prospects between the UK and the US?

Mark Carney: Well the expansion in the US, say generally, the expansion in the US is more developed; it's been going on longer than it has been in the UK. We've had quite different labour market dynamics. The US had a sharp fall in participation; it's now starting to come back, whereas we've had the opposite. We've had - I think we'd characterise it as a positive labour supply shock; there's been more workers coming into the market, and that's had implications for the path of wages here.

In terms of the inflation dynamics, we have - as a consequence of the differences in the labour market, there have been some distinctions in - there are differences, I mean there are basically differences in the net inflation dynamics. I know you're not suggesting this but just to avoid any doubt, we're not in a situation where we're so tightly bound to the US economy, or we would take so much information from what happens in the US economy, that monetary policy in the UK would move either in lock step or follow closely behind that in the US. And I don't think - make a market comment - I don't think that there's confusion about that in the market. I think we've seen our curve move by and large - by and large - consistent with the forces that are operating here.

Ian King, Sky News: You talk in the Report about the fact that labour force - the labour participation rate has been lower than expected in recent months. To what do you put that down? And what are the implications for you if that continues with regard to

what the Prime Minister was saying the other day about wanting Britain to have a pay rise?

Mark Carney: Well, let me say one general - let me make a general point and then I'll ask Ben to speak about the specifics of it. Which is that one of the things that the MPC has been discussing has been how to update our thinking around potential growth, components on the labour side or with respect to productivity. And of course we get information about both of those on a daily basis and there's a temptation to make adjustments in every report.

I think what we're minded to do - and we'll probably start doing this in May - is to set out episodically or periodically update on it, not episodically, periodically update our views - so in terms of the so-called equilibrium variables. I'm sorry this is a tacky answer, you don't want that, but Ben will give you a real answer. So whether it's around participation rate - your question, or around the natural rate of unemployment or the amount of average hours reported. And so we take stock and we're clear and then we hold those for a while.

What we've been seeing is that actual participation has come out lower, first than we would have necessarily expected, but a gap has opened up between what we think is a sort of equilibrium level of participation and what we're actually observing.

Ben Broadbent: The only thing I'd add is - if you look at the numbers and they're in Chart 3.5 which is on page 25, you can see that in the short term they're pretty volatile. The broad judgement we've made, which I think is the right one, is that quite a bit of the decline in this we saw, particularly when we went into recession in 2008/9, was cyclical, which is to say that a lot of the people who lost their jobs rather than looking for work and being counted as unemployed, instead sort of dropped

out of the labour force but that they would be able to come back relatively easily.

And that basically remains our judgement. And indeed as the economy has recovered you've seen, except for this dip in the last three months, a revival in productivity growth. So that's broadly still the judgement we're making and it's one of the sources therefore in the forecast of potential supply growth and employment growth over the next two to three years.

Duncan Weldon, Newsnight: The current account deficit is currently near a record level, about 6% of GDP, and over your forecast period you say that gradually improves but the deficit remains wide. And that sounds more pessimistic than the OBR's forecast who see quite a rapid improvement in elements of the current account. You say in the Key Judgements - the magnitude of the current account deficit suggests some risk to the sustainability of the growth outlook. So it's a two-part question, how big a risk and over what time period will you be watching that risk?

Mark Carney: Well you're right; the current account deficit is let's say at a record level. I mean it's been bouncing around a bit, but at 6% of GDP it's at a record level. I think the first thing is to look at why has it deteriorated, why has it shifted. And the answer is not in the trade balance, it's not actually in the relative performance of exports and imports - both have been growing less rapidly than expected, but in terms of balance it hasn't moved so much. The big news has been in the swing in our net investment income, and quite a substantial swing. And it counts for the lion's share of the shift in the current account.

Now why is that the case? Well you'd look at the big areas where British investments are. Top of the list is in the euro area, so much lower returns on - and these are real investments, so lower returns on real investment in Europe.

And that could persist for some time, so this issue could persist for some time.

When you run a current account deficit, you're relying on foreign inflows of capital. So it matters how you finance it in terms of the sustainability, and that depends on the relative attractiveness of a country, as ultimately it depends on the relative attractiveness of investments in a country.

At present the relative growth prospects in the UK are near the head of the pack in the advanced economies, and with our forecasts and the IMF's forecasts - you could take an independent one - that's likely to continue. So that makes it attractive. But also the UK is an attractive destination for foreign direct investment; it gets the lion's share - a disproportionate large share, I should say - of foreign direct investment for countries in the European Union. And so it underscores the importance of continuing to remain an attractive destination for investment.

We have looked, the last point I'll make on this, Duncan, is that we have looked not as the MPC but as the FPC, we have looked at what could happen, what could be the implications of a sharper adjustment in the current account. What if we no longer could rely on the kindness of strangers, if you will. And that was the motivation for the stress test we ran and the results were released in December. And it's a hypothetical scenario, but it is one that connects the dots from a tightening current account position to the implications for growth for in that case house prices, bank balance sheets.

And the punch line on that wasn't a great scenario, it wouldn't have been a fun thing to live through; it was an extreme scenario and it was a stress scenario. But the punch line on that was that our determination was that the core of the system, the core of the banking system, was resilient to

that form of shock and still would have been able to provide lending to the UK economy.

Jenny Scott: Okay, last question.

Nathalie Webb, Share Radio: Because you say that housing investment and mortgage approvals are down, they're weaker than expected, do you see any sort of changes to try and encourage the banks to lend a bit more because also people have got more disposable income to create a bit more stimulus in that area?

Mark Carney: No, I would say the - you know we have our, from a monetary policy perspective, we have our forecast of housing activity; it is lower than it had been previously. From a broader perspective, broader Bank of England perspective, whether it's the PRA or the FPC, our focus has been to ensure that bank underwriting standards remain responsible. We're not looking to encourage a shift towards - you would say it's a surprise - we're not looking to encourage a shift towards irresponsibility or so-called reckless lending. That was the motivation of the steps that the FPC took in the spring of last year to limit the amount of high loan to income mortgages that could be written, and that remains the case.

By taking those steps, and I'll end with this on monetary policy, by taking those steps, by reducing risks, financial stability risks that could arise from irresponsible lending in the housing market, risks that go back to the question about debt, Ben's question about debt. The FPC preserves room for the MPC to conduct monetary policy to provide the appropriate amount of stimulus in order to get inflation back to target. Because if the FPC weren't doing its job as the first line of defence, then the MPC would have to potentially take these considerations into account, which would be difficult at the current juncture. Thank you.

Jenny Scott: Thanks very much everyone.

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