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Opening Remarks by the Governor

From an economic perspective, the last decade ended with a whimper.

The global economy moved from a broad-based expansion to a widespread slowdown, with manufacturing slipping into recession, global trade contracting, and overall growth falling to its weakest pace since 2009.

In the UK, entrenched Brexit-related uncertainties added to the global drag on domestic activity. Last year, the UK economy grew at its weakest pace since 2010, as business investment remained subdued, despite having barely grown at all in the prior few years, and households began to rebuild savings and cut back on durables spending, despite the resilient labour market. Overall, UK activity likely stagnated in the final quarter of 2019, leaving the economy operating with a margin of excess supply.

In parallel, CPI inflation fell below the MPC's 2% target, reaching 1.4% in 2019 Q4. While this weakness largely reflects energy prices, core inflation has also slowed, and domestically generated inflation pressures, outside the labour market, remain contained.

The question facing the MPC at this meeting was whether the new decade is starting with a bang.

Certainly, political developments have been significant, leading to the UK's historic withdrawal from the EU tomorrow evening.

On the economic front, the bar is more modest. At its December meeting, the MPC had projected that UK growth would pick up from below to above potential rates, supported by a reduction of domestic uncertainties, and a modest recovery in global growth.

On balance, early indications are that both conditions underpinning the projected UK recovery are on track.

The most recent signs are that global growth has stabilised, reflecting the partial easing of trade tensions and the impact of the significant loosening of monetary policy by many central banks over the past year. The global manufacturing PMI has returned to expansionary territory, helping push the composite PMI to a six month high in December. And the hard data seem to be following suit, with global industrial production swinging from contraction to expansion in November, and recent growth outturns in the euro area, the US, and non-China emerging market economies coming in slightly stronger than expected.

Domestically, indicators of uncertainty have fallen, broadly as the MPC had expected in its November projections. For example, the proportion of firms citing Brexit as one of their top three sources of uncertainty in the Bank's DMP Survey fell below 45% in January from 55% in November, and sterling implied volatilities have fallen substantially since the election.

Hard data, released in January, but related to activity prior to the election, was generally soft. More timely survey data that relate to output growth following the election have increased sharply, with the movements particularly marked in the most recent releases. The very latest surveys suggest growth will pick up in the first quarter to around 0.2%, in line with the MPC's projections three months ago.

Businesses reported a sharp rise in investment intentions in the recent manufacturing CBI and Deloitte CFO surveys. And there are signs that lower uncertainty is boosting housing market activity, the area of consumer spending where the drag from Brexit had been most evident.

The latest data also show that the labour market remains resilient, with employment growing strongly towards the end of last year and unemployment at its lowest level in over 40 years. Vacancies rose modestly in December, reversing the pattern of near continuous falls since the start of 2019 and tempering earlier signs of a slowing in labour demand. Households remain confident about their own financial situation, and their confidence about the general economic outlook has improved to its highest level in a year and a half.

Reflecting these positive developments, the MPC judged that it was appropriate to maintain policy.

To be clear, these are still early days, and it is less of a case of so far so good, than so far, good enough. It will be important for the hard data on activity to follow through on the recent pickup in the surveys, and for domestic price inflation to strengthen.

Though the global economy looks to be recovering, caution is warranted. Evidence of a pickup in growth is not yet widespread. And any one of the known risks, such as a renewal of trade tensions, could reverse recent progress. The emerging threat from a new strain of coronavirus is a reminder of the need to be vigilant.

In the UK, although early signs are encouraging, the recoveries in growth and inflation are also not yet assured. Uncertainty is still elevated by historical standards. Stronger investment intentions need to be translated into action. Domestic price inflation has remained muted even as growth in unit labour costs has risen. Core inflation has slowed over the past year, and core services inflation has generally been some way below the rate estimated to be consistent with inflation at target.

Supply Stocktake: More slack to start, but slower potential growth

In its annual reassessment of the supply side of the economy, the MPC judged that the weakness in domestic price inflation indicated that the margin of slack has been slightly greater over the past few years than it had previously estimated. At present, excess supply is estimated to be around of ½% of potential GDP. That spare capacity lies within companies, with little slack apparent in the labour market.

However, it is unclear whether the wider margin of slack can fully explain the weakness in domestic prices relative to the strength in labour costs, and for how long that weakness might persist. The Committee will explore these issues further over coming months, considering UK developments in the wider context of relatively subdued inflationary pressures, but strong labour markets, globally.

The MPC also reviewed the outlook for supply over the forecast, judging that productivity growth would pick up only a little from current rates. That judgment reflects:

- Some continuation of the experience since the financial crisis of persistently weak productivity growth;
- A period of very weak business investment in recent years; and
- The weight on productivity in the short term from the adjustment to the UK's new trading relationship with the EU.

The slower rate of potential growth also reflects a more modest rate of expansion in labour supply, as the two factors that have boosted it in recent years – namely rising trend participation and falling equilibrium unemployment – are not expected to continue, given their historically strong levels.

The MPC's latest projections

In MPC's latest projections, the tentative signs of a global recovery are borne out, with growth rising back to potential rates. Domestically, uncertainty fades gradually, as more details about the new trading relationships emerge and companies assess how those affect their business.

Overall, conditioned on the market path of interest rates and the increased Government expenditure announced in last year's Spending Review, UK growth is forecast to rise above the weakened rate of supply growth, slack is expected to erode gradually over the first part of the forecast period and a margin of excess demand to build thereafter.

CPI inflation is projected to remain notably below the MPC's 2% target throughout this year and much of 2021, partly reflecting the impact of lower utility bills. Thereafter, the drag from lower utilities prices fades and domestic price pressures strengthen in response to the erosion of spare capacity. As a result, inflation reaches the 2% target by the end of next year and rises slightly above it by the end of the forecast period.

Policy

Monetary policy may need to reinforce the expected recovery in UK GDP growth should the more positive signals from recent indicators of global and domestic activity not be sustained or should indicators of domestic prices remain relatively weak. Further ahead, if the economy recovers broadly in line with the MPC's latest projections, some modest tightening of policy may be needed to maintain inflation sustainably at the 2% target.

The UK economy is entering a decade of potentially profound structural change. New trading arrangements will be struck. A new immigration policy will introduced. Major initiatives are likely on infrastructure, regional development, and the transition to a lower carbon economy. The MPC will need to assess the implications of all these developments for the balance of supply and demand and set policy to deliver price stability in a way that helps smooth adjustment and supports jobs and growth for the good of all the people of the United Kingdom.