



BANK OF ENGLAND

News release

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Mervyn King speech to the Plymouth Chamber of Commerce and Industry 187th Anniversary Banquet

In his speech, Mr King explains that while the MPC can try to maintain stability in the economy as a whole it cannot prevent movements - like a see saw - between external and domestic demand, which result from changes in the exchange rate or the world economy. He tells his audience that it is lurches in this see-saw which produce damage - as manufacturing and agricultural businesses know only too well, and as domestically-oriented businesses saw in the early 1990s.

He says "At present domestic demand is up and external demand is down. One way or another the imbalances in the world economy will be corrected. That is likely to go hand in hand with changes in exchange rates and other asset prices. Whether this will happen gradually or through a sharp adjustment is impossible to know. But those changes will have a major influence on the speed at which the economic see-saw in the UK will move back to balance.

The message for policy is that it is important not to let domestic demand grow too rapidly for too long. The longer the correction is left, the sharper the required adjustment will be. The higher one end of the see-saw, the greater the subsequent lurch will be. The trade deficit cannot continue to widen indefinitely. Hence, at some point domestic demand will have to grow at below its sustainable trend level rather than significantly above as it has done now for some time - over 4% a year on average over the past four years.

By acting pre-emptively, and trying to anticipate developments, the MPC has been able to maintain overall stability in the economy, but the sharp rise in sterling led to a lurch in the economic see-saw... Pre-emptive action to slow domestic demand growth to a more sustainable level is the key to avoiding a larger and more painful adjustment at a later date. That is why the MPC has raised interest rates by 100 basis points since September."

Key Resources

Balancing the Economic See-Saw – Full Speech

<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2000/speech82.pdf>