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News release

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Monetary Policy and Manufacturing Industry – Speech by Mervyn King

Mervyn King, Deputy Governor, today spoke about monetary policy and the problems facing manufacturing industry to a lunch hosted by the Black Country Consortium at Molineux, Wolverhampton.

Mr King highlighted the fact that since the Monetary Policy Committee was set up in May 1997, inflation has remained close to target and that, during this time, policy had reacted to large swings in the world economy and to the prolonged strength of sterling. He said: "Interest rate changes have maintained stability in the economy as a whole. But manufacturing has been hit disproportionately, especially by the rise in sterling."

Discussing the recent problems facing manufacturers, Mr King said: "You may feel that monetary policy should take special account of the position of manufacturing industry. I can certainly share the frustration of those who, having first created and then built up a successful business, find that its future founders on events totally outside their control. But what would taking special account of manufacturing mean in practice? Let me start with the exchange rate."

Looking at the current problem of the high level of sterling against the euro, Mr King outlined some of the factors that might explain exchange rate movements. He said: "… three factors – interest rate differentials, the sustainable level of the exchange rate, and the riskiness of sterling against the euro – imply that sterling is more likely than not – I would put it no stronger – to fall against the euro in the next two years or so." But he stressed: "…the timing and magnitude of any such fall are unknowable…In the interim, although there is little that the MPC can do to influence the exchange rate, it can take its movements into account when setting interest rates. That it most certainly does."

Mr King highlighted what monetary policy could do to help, and what it could not do. He said: "Higher inflation might, it is true, initially raise your output prices, but it would soon also raise your costs… High inflation in the past did not raise manufacturing profitability". He added: "If interest rates were set to achieve some other target, such as a particular, and presumably lower, level for the exchange rate, then, in present circumstances, inflation would be likely to move above the target. Inflation expectations would rise, losing their anchor, and we would be back in the inflationary cycles of the past… The only way for the MPC to bring down sterling would be to abandon its commitment to meeting the inflation target. He said this "would undermine the hard won credibility of the UK's commitment to low inflation. …Monetary stability is not a fair weather policy."

Turning to what had been achieved, Mr King said: "To borrow a phrase, the MPC is pre-emptive for a purpose. Only by keeping inflation close to the target, and maintaining confidence among businesses and wage bargainers that inflation will indeed stay close to the target, can we hope to achieve overall macroeconomic stability."

"There will always be pressure on the MPC to adopt the quick fix to deal with today's situation. But the task of the MPC – as given to us by the Chancellor – is to look further ahead and ensure stability in the longer term."

Mr King concluded that in the 30 years since he left the Black Country, the value of money had fallen by over 90%. High inflation went hand in hand with a falling exchange rate. At the same time, manufacturing declined. He said: "Monetary instability has not been good for manufacturing."

Notes for Editors

Mr King was speaking at Molineux as part of a regional visit to the Wolverhampton area, accompanied by the Bank of England's Agent for the West Midlands, Mr John Bartlett.

The day was one in a series of regular regional visits undertaken by members of the Bank of England's Monetary Policy Committee.

Mr King also visited Thomas William Lench Ltd in Warley, hosted by Mr Robert Lench, Chairman and Managing Director. Afterwards, he spoke at Wolverhampton Grammar School, his former school, on the topic of UK economic policy to an invited audience of local schools. He took this opportunity to launch "Target 2 Point 5" - The Bank of England/Times Interest Rate Challenge – a new competition for students aged between 16-18 years old (see separate press release for further details).

Key Resources

Monetary Policy and Manufacturing Industry - Full Speech

http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2000/speech78.pdf