



BANK OF ENGLAND

News release

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The New Economy: Myths and Realities – Speech by Sushil Wadhvani

In his Travers Lecture at the London Guildhall University today, Dr Sushil Wadhvani, an external Member of the Bank of England Monetary Policy Committee, argues it is possible that measurement issues have led forecasters to overestimate inflationary pressures in the UK economy in recent years.

Dr Wadhvani says that, for example, alternative assumptions about the measurement of investment in computers and software might, on some preliminary estimates, increase measured productivity growth by as much as 0.4 percentage points per annum. Importantly, some preliminary work suggests that these alternative data might have lowered the equilibrium rate of unemployment in the Bank of England's Medium-Term Macroeconometric Model (MTMM) by about 0.5 percentage points in 1999, which, if interpreted mechanically, would have lowered estimates of inflationary pressure.

Dr Wadhvani provides a second example where some preliminary estimates of an alternative measure of the flow of capital services would have significantly reduced the estimate of capacity utilisation in the model, thereby again reducing the estimate of overall inflationary pressure.

In a wide-ranging lecture on the New Economy, Dr Wadhvani notes that historically, periods of significant technological change have often been associated with significant volatility in share prices and corporate investment. For example, the share price of electrical companies fell by around 93% after the 1882 electrical mania and this did lead to a temporary collapse in investment spending. However, it did not stop the UK eventually reaping the benefits of electricity. In the current context, Dr Wadhvani points to survey evidence suggesting that UK businesses continue to expect e-business to become more important. He argues, though, that interpreting productivity growth statistics through a downturn in the US will require extreme care as it is possible that the New Economy might have increased the cyclical variability of productivity growth while also increasing its average level.

A summary of the lecture and the full text are enclosed with this News Release.

Key Resources

The New Economy: Myths and Realities - Full Speech

<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2001/speech119.pdf>