



BANK OF ENGLAND

News release

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Three Questions and a Forecast – Speech by Mervyn King

In a speech today at the annual dinner of the North-East Region of the CBI in Newcastle upon Tyne, Mervyn King, Deputy Governor of the Bank of England, discusses three current economic questions: why the world economy has turned down so rapidly, whether the UK is heading for recession and when the imbalances between manufacturing and services will come to an end.

In his speech, Mr King says: "the proposition that it takes time before monetary policy has its full impact on the economy is quite different from the proposition that monetary policy is ineffective. And the Monetary Policy Committee takes the view that the influence of policy easing will gradually come through and its effects will be seen over the next year or so. Of course, there are many risks to this outlook. None of us knows how the present uncertainties will be resolved. Again, however, monetary policy stands ready to respond to any unexpected developments, whether on the upside or the downside."

The risks are in both directions, Mr King says: "Projecting a slowing of consumption has, for some time, represented the triumph of hope over experience, and the data published today, showing a rise in consumption in the third quarter of 1.3% and of 4½% on a year ago, do nothing to change that. It would be very unusual for output to fall immediately after a year in which money and credit have grown, in real terms, as fast as they have over the past twelve months. On the downside there are clear risks from the world economy. Whenever the United States has experienced two consecutive quarters of falling output, GDP in the United Kingdom has fallen in at least one of those quarters. And in the October CBI Survey optimism regarding export prospects fell to its lowest level since 1980. So there are risks aplenty. But the most likely outcome is a continuation of growth, albeit at a slower pace for a while, with low inflation.

I would urge you, however, to consider the wider picture. Relatively small changes to quarterly growth rates are neither of critical importance in themselves, nor something over which monetary policy has much influence. No policy framework can abolish the business cycle. It is the large and persistent fluctuations of output which are damaging, and which the MPC can influence by the application of a pre-emptive monetary policy in pursuit of the inflation target looking beyond the next few months to the outlook two years or so ahead."

Mr King concludes that: "From time to time, sharp swings in the world economy will affect the UK. That has clearly been the case this year. But, given time, monetary policy will be able to promote stability. Now is the moment for prudence to be joined by patience as the watchwords of economic policy. By setting interest rates in a pre-emptive fashion, the Monetary Policy Committee is determined to prove that it really is a Committee for all sectors, all regions and all seasons."

Key Resources

Three Questions and a Forecast – Full Speech

<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2001/speech151.pdf>