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Economic Stability and the Business Climate - Speech by Kate Barker

In a speech today at the Managing Directors' Club, Sheffield University, Kate Barker – a member of the Bank of England Monetary Policy Committee – considers the significance for the future behaviour of the economy given the strikingly different trends in stability for the whole economy against individual firms. Stability in this context refers to the volatility of output growth. She also discusses recent economic performance and prospects for the UK economy.

Ms Barker says: "...the relative stability of the macroeconomy is not necessarily repeated at the level of the individual firm." Drawing on Bank of England research, she observes: "...preliminary work suggests that the 'Great Stability' of the UK economy since the inception of inflation targeting has not been reflected at the level of individual firms – and indeed that in the UK individual firms may have seen increased volatility for sales and for profits."

She offers reasons that may explain the diverging trends in stability at the firm versus the macro level: "As markets have become more open to competition, firms look harder at how their competitors may react, and may be more cautious in their approach to wage and price setting – especially in an environment where their inflation expectations are firmly anchored. Firms may also be more likely to perceive shocks as idiosyncratic. This leads to greater variation in outcomes for firms but to a benign macro environment in which policymakers can deliver low inflation, and reinforce the message of aggregate stability."

Ms Barker adds: "... since 2001 there has been a general slowdown from a period of strong growth..." but notes that in the MPC's latest Inflation Report "...the central projection was for GDP growth to recover quite strongly..." She posits that in addition to the various risks outlined in the Report, there are those "...which may not crystallize until beyond the forecast period, but could at some time have probable downside implications for growth. One key risk relates to long-term real global interest rates, which are presently at low levels by historical standards."

Ms Barker concludes: "Taking a longer view, it is encouraging that...the contrast between aggregate and individual volatility may support the resilience of the economy to shocks. But there are other concerns. Since 1997, the MPC's reputation has been good – and there has been a good outturn not just in terms of low and

stable inflation, but also improvements in household income growth, rising asset values due to lower real long-term interest rates and a declining unemployment rate. As discussed, for the most part credit for these other favourable trends is not due to the MPC. Prospects appear rather less positive. Recent trends in import prices to the UK (Chart 9) suggest that the terms of trade improvement may not continue. Real long-term interest rates are unlikely to fall further. The decline in the rate of unemployment consistent with stable inflation seems likely to have come to an end. But while this is a note of caution, it should not be overplayed. It is possible that other favourable trends could emerge – such as sustained faster euro-area growth, or an improvement in the UK’s productivity performance. Even if these do not occur, while the outlook may be less favourable than the recent past, it is still good when compared to a longer historical perspective. And of course whatever emerges, the MPC will continue to focus on the important goal set for us by Government, of delivering low and stable inflation.”

Key Resources

Economic Stability and the Business Climate

Speech by Kate Barker, Member of the Monetary Policy Committee, at the Managing Directors' Club, Sheffield University on 24 November 2005

<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2005/speech260.pdf>