



BANK OF ENGLAND

News release

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2009: A Review of the Economic Year - Speech by Spencer Dale

In a speech given today to the Essex branch of the Institute of Directors, Spencer Dale - Chief Economist and Executive Director for Monetary Analysis and Statistics - discusses the policy response to the economic downturn, evidence that the economy has stabilised, and the prospects for 2010 and beyond.

Spencer Dale begins by reviewing the synchronised nature of the global recession, noting that it was driven by tight credit conditions, amplified by a collapse in confidence. He says that: "The fall in household and firms' confidence proved mutually reinforcing and, to some extent, self-fulfilling: both households and firms expected conditions to weaken sharply and both cut back on spending." He adds that this withdrawal further exacerbated the weakness in the banking system, which threatened to feed back and extend the retrenchment. In such situations, he says, ".it falls to policy to break the ensuing vicious cycle".

He turns to reflect on the domestic and international policy response. He notes that the MPC's interest rate decisions have acted to improve companies' cash flow and lower the monthly repayments of households holding floating rate mortgages, while encouraging both groups to spend rather than save. He adds that the MPC's programme of asset purchases has further stimulated demand by reducing yields across a range of assets and lowering the cost of company finance. He believes these measures, in combination with the range of Government policies, ".have been successful and the risk of a severe adverse feedback loop.avoided". As evidence, he points to the rises in corporate insolvencies and unemployment, both of which have not increased by as much as might have been feared on the basis of past recessions.

He continues by looking at the prospects for 2010 and beyond. Spencer Dale states that: "The economy appears to have turned" and ".we are likely to be moving into a period of renewed expansion". He points to the depreciation of sterling as providing additional support to the recovery, along with the further boost to output expected as the adjustment of inventories by companies runs its course. Spencer Dale warns however that ".the emerging recovery should not obscure the fact that structural adjustments need to occur in our economy". He notes that monetary policy cannot and should not prevent these adjustments happening. But he says, ".the job of monetary policy.is to ensure that these adjustments occur in as orderly a manner as possible and within an economic environment which is consistent with hitting the 2% inflation target".

Spencer Dale concludes by reflecting on the most recent monetary policy decision and his vote to maintain the level of asset purchases at £175bn in November in contrast to other Committee members who wanted an increase. He says it is important not to make too much of this difference. "I fully recognised the potential benefits of a more expansionary policy given the downside risks to the economy. However, I was also wary of the potential risks of such a policy." He notes his main concern reflected the considerable uncertainty about the degree of spare capacity in the economy and the behaviour of inflation when output is growing at above trend rates, adding that his preference ".was to aim to grow the economy a little less rapidly". He was also concerned about unwarranted increases in some asset prices, but is careful to stress that: "I do not think there is any strong evidence to suggest that any of the increases in asset prices seen to date are out of line with the improving economic outlook and the desired impact of our asset purchase programme." "Rather, I was conscious that the current stance of monetary policy.increases the likelihood that some asset prices may move out of line with their fundamental values and that this could be costly to rectify were it to occur."

Key Resources

2009: A Review of the Economic Year - Full speech

<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2009/speech416.pdf>