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"After the recession: thoughts on the growth potential of the United Kingdom"- speech by Martin Weale

In remarks made at the Department for Business, Innovation & Skills Analysts' conference, Dr Martin Weale - an external member of the Bank of England's Monetary Policy Committee (MPC) - discusses the impact of the recent crisis on the level and future growth rate of potential output in the United Kingdom, and what role monetary policy can play in supporting the economy.

Martin Weale begins by reviewing three factors consequent from the financial crisis and ensuing recession that might affect the level of supply capacity in the United Kingdom. First, he provides an estimate of the negative effect of an increase in the cost of capital for companies resulting from the post-crisis re-pricing of risk by banks and financial markets. Second, Dr Weale describes the possible impact of increased unemployment, and its duration, on productive capacity. But - opposing those factors - Martin Weale also suggests that a successful rebalancing of the UK economy away from public spending and towards private sector manufacturing production could help offset the reduction in potential supply, and improve its growth rate looking ahead. He stresses that such an effect may simply arise from the way in which GDP is measured, without saying anything about whether public sector employment is inherently more or less productive than private sector employment.

Overall, Martin Weale says that the financial crisis may have resulted in " ... an eventual loss of output of 2½-5 per cent relative to what had seemed to be the sustainable level before the crisis", although " ... if rebalancing proceeds successfully this may fall somewhat".

In addition to a rebalancing of production towards the private sector, Dr Weale reviews evidence suggesting that policies designed to increase the UK workforce's educational attainment may raise potential output growth in the future. In particular, he believes that life-long learning - studying for additional qualifications during working life - may have just as significant an effect on earnings potential and productivity, as more conventional academic studies. For example, he states: " ... men aged twenty-five who acquire qualifications which raise their educational attainment . raise their life-time earnings by 12-14 per cent", and " ... the effect for men with no initial qualifications, at 21 per cent, is larger."

Finally, Martin Weale assesses the role that monetary policy can play in supporting the economy. He says: "We should never forget that spare capacity amounts to a waste of resources and that the associated unemployment is a source of misery."

On the MPC's current policy dilemma, while acknowledging a large degree of uncertainty, Martin Weale's calculations imply it likely that "there is spare capacity of the order of 4-6½ per cent of current GDP" such that there is probably room for the economy to expand by a similar amount as a cyclical recovery. He says: "... it would be right for the Monetary Policy Committee to do what it could to stimulate the economy further, provided that such a stimulus were consistent with meeting the inflation target". However, he adds, the MPC has "... to be sensitive to the fact that inflation in September was more than one percentage point above its target ." and " . may well rise further, even if a subsequent decline is expected". He states: "I certainly worry about the effect on inflationary expectations of introducing additional monetary stimulus in such circumstances."

In conclusion, Martin Weale describes the MPC as charting " ... a course between the Charybdis of recession and deflation and the Scylla of excess inflation". The recent stability of the monetary policy stance does not mean that MPC members " ... cannot make up our minds", Martin Weale argues. But he states that "whether this will seem the right decision with the benefit of 20:20 hindsight is a question I will have to leave for a future occasion."

Key Resources

"After the recession: thoughts on the growth potential of the United Kingdom"- Full speech

<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2010/speech461.pdf>