BANK OF ENGLAND

Press Office
Threadneedle Street
London EC2R 8AH
T 020 7601 4411
F 020 7601 5460
press@bankofengland.co.uk
www.bankofengland.co.uk

News release

24 November 2010

Getting Back to Business - Speech by Andrew Sentance

Speaking at a Bank of England / CBI hosted event today in Belfast, Andrew Sentance - an external member of the Monetary Policy Committee - looks at the progress of the economy so far and the challenges ahead as recovery progresses. He says: "... the key challenge now facing the UK economy is to ensure that the private sector and the nation's business community can be a powerful and sustained engine of job creation and growth as the public sector rebalances".

He highlights three grounds for optimism that a healthy, business-led recovery can be sustained in the UK while public spending is restrained and the deficit is brought down: the progress of the recovery so far; the resilience of UK businesses through the recession; and the experience of the previous recovery in the mid-1990s, when there was also a significant rebalancing of public finances.

On the progress of the recovery so far, he notes that recovery started at an earlier stage of the cycle than that following the previous recession, and manufacturing has been growing faster than the services sector with surveys generally positive about that continuing. He says these are "...encouraging signs for the rebalancing of the UK economy...". He adds: "These rates of growth - across the UK economy as a whole and in manufacturing - would not be possible unless the demand climate had changed very significantly over the course of the last 12-18 months." Strong global demand and a competitive exchange rate have allowed UK goods exports to rise by close to 15% over the past year. And, because exports and domestic private sector spending make up over 90% of the demand for businesses, "...while the global economy continues to perform strongly and as long as private sector demand is still growing at a reasonable rate, UK plc should be well-placed to cope with the squeeze on public spending...".

Discussing business resilience through the recession, Andrew Sentance highlights three positive features about the supply-side performance of the economy in this recovery. First, the resilience of employment through the recession and evidence of a pick-up in private sector jobs at a relatively early stage of the recovery. He says: "Given the personal difficulties and waste of resources created by high unemployment, the fact that employment has held up well in the recession - and is now rebounding - is very encouraging". Second, the ability of companies to maintain their financial strength through the downturn, which has put the corporate sector in a better position than in previous to increase investment as demand recovers. Third, the

low level of company failures, where he notes that: "Instead of slack being created in the labour market through company failures and job losses, there is the possibility that more spare capacity has been retained within companies...".

Alongside this resilience of the business sector, the UK has also experienced relatively high inflation. Part of the reason for above-target inflation is a number of upward price shocks from a range of different sources including import prices and VAT. But he suggests that "... spare capacity has not exerted as much downside pressure on cost and price increases as expected. That is partly because the margin of spare capacity appears to be less than we have seen in previous economic cycles." He outlines that spare capacity in the service sector in particular does not appear to be holding down inflation.

In response to his assessment of recovery prospects and the inflation outlook, Andrew Sentance sets out three arguments for a gradual rise in interest rates. First, the main elements of demand for UK businesses have been recovering for over a year and look set to continue to grow. The UK economy should be able to withstand a gradual rise in interest rates, even taking into account the impact of fiscal consolidation. Second, higher interest rates should help to exert a brake on above-target inflation and keep inflation expectations anchored around the 2% target. He says: "Raising Bank Rate sooner rather than later would provide more protection against...upside risks..." and "...help build confidence that the Bank of England is 'on the case' in terms of its remit...". A third argument is the extremely low level of interest rates. He says: "Taken together with the monetary stimulus from Quantitative Easing, there is still likely to be a considerable support for growth from monetary policy even if interest rates are raised somewhat from their current level." He adds: "The longer we keep interest rates at an exceptionally low level, the greater is the risk that Bank Rate would need to rise sharply in the future - creating a serious setback to business and consumer confidence. We should seek to avoid such a sudden lurch in policy."

Concluding, Andrew Sentance says: "As the private sector of the economy 'gets back to business' and we get accustomed to a resumption in growth following the financial crisis, so monetary policy also needs to 'get back to business'."

Key Resources

Getting Back to Business – Full speech
http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2010/speech464.pdf