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News release

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Let it grow: how monetary policy can support sustainable economic growth - speech by Andrew Sentance

In a speech to the East of England CBI, Andrew Sentance - External Member of the Monetary Policy Committee - discusses the prospects for the economic recovery, and the way that monetary policy can best support it.

Andrew Sentance begins by putting the current recovery in context. On the weakness of the GDP data for the fourth quarter of 2010, he says: "Economic recoveries are normally uneven - particularly in their early stages - and we should not be surprised to see significant fluctuations in the GDP growth rate from quarter to quarter." He adds that until the end of the last year, the recovery had been stronger than the equivalent recovery periods of the early 1980s and early 1990s. "Manufacturing industry has performed particularly strongly, benefiting from the global recovery and a competitive pound, and the recent annual growth of manufacturing output has been the strongest recorded since 1994", he notes. He argues that the latest employment data and business surveys for the early months of the year are consistent with a continuing economic recovery.

He then goes on to discuss the outlook for growth further ahead, expecting the manufacturing sector to continue to perform strongly, supported by strong growth across the world economy. He says: "The economies of Asia and other emerging markets are likely to continue to provide strong momentum to global growth, and the gradual recovery which is emerging in the United States and continental Europe should continue to gather momentum". Citing survey evidence on businesses investment intentions, Andrew Sentance suggests that "Business investment should also be a positive force for growth over the next couple of years", as firms dust off the investment plans put on hold during the recession.

If the world economy is growing healthily and investment is rebounding, why is UK economic growth expected by many to be so disappointing, Andrew Sentance asks - "The answer lies in the outlook for public and private consumption". However, he says: "It is not surprising that public sector spending will act as a dampener on the growth of the UK economy as the government rebalances its finances. We experienced a similar phenomenon in the mid-1990s as the economy recovered from the early nineties recession." Regarding household spending, he says that an important contributor to the expected weakness this year is the squeeze on household incomes from high inflation. "...We should not be surprised to see a squeeze on real incomes and relatively subdued consumer spending in the first half of this year", he adds. But he notes evidence that private sector pay settlements have begun to move up and says "In my judgement, there are upside risks to both inflation and consumption growth from a stronger rebound in wage growth as the recovery proceeds. This is one of the reasons ... why I believe that the current Inflation Report forecast that inflation will fall back to the 2% target is relatively optimistic."

Finally, Andrew Sentance discusses the role of monetary policy in supporting the recovery. "While monetary policy can affect the growth rate of the economy in the short term, over the medium to long term, economic growth is driven by supply side factors - enterprise, innovation, investment and skills", he says. He adds that previous attempts to boost growth by loose monetary policy, in the 1970s and late 1980s, resulted in greater economic instability. He says: "The best contribution that monetary policy can make to supporting the underlying forces of growth is therefore by fostering a climate of stability - primarily in terms of the level of prices but also by seeking to promote a relatively stable demand climate and by avoiding potentially destabilising lurches in policy". He argues that inflation "...could easily rise above 5% later this year...", and concludes by saying that: "...failure to take timely monetary policy action risks a more abrupt and destabilising rise in interest rates in the future. That is surely something which the businesses represented here today would not want to see. And that could be a much bigger threat to future economic growth than the gradual increases in interest rates which I have been arguing for since the middle of last year."

Key Resources

Let it grow: how monetary policy can support sustainable economic growth – Full speech