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News release

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The challenges of the 'New Global Economy' - speech by Andrew Sentance

In a speech to the Jersey Chamber of Commerce, Andrew Sentance – External Member of the Monetary Policy Committee – describes the way in which the global economy has become more integrated and interdependent, and the challenges those changes pose, including for the MPC.

“Four main forces have come together in the past two decades to create the ‘New Global Economy’ of the 21st Century”, Andrew Sentance says. “First, new technologies have had a major impact, notably the development of global information technology, media and communications networks. Second, barriers to trade have been reduced, with most of the world’s nations now participating in a liberal and open trading system”. “Third, political change has extended the global market economy to large parts of the world which were previously closed to international trade and investment... And fourth, there has been a tide of deregulation of markets – including financial markets – in many countries, and as markets have been deregulated, they have also been opened up to international competition.” He goes on to discuss the challenges these factors pose, and in particular: “how can economic policy-makers maintain stability when we are constantly in danger of being buffeted by powerful global economic forces?”

The first challenge is presented by the shift in the centre of global economic gravity towards Asia. The pattern of the last thirty years, Andrew Sentance argues, has been “...of a successful Asian model of development spreading out and ... becoming more self-sustaining. The most likely scenario is that this pattern will continue over the next 20-30 years...”, he adds. “The key for economies like the UK, other European economies and the United States to prosper and succeed in this new world economic order is to have the right supply-side policies which help businesses to remain competitive and adapt to changing market conditions.” Such policies might include those aimed at enhancing education levels, and maintaining a business climate which is conducive to enterprise and innovation, along with a flexible labour market.

As a by-product of continued Asian economic development, Andrew Sentance expects “...a prolonged period of upward pressure on energy and commodity prices”. This is the second challenge for policy makers, Andrew Sentance notes, creating the risk that “...the inflationary trend could become embedded in the rate of increase of wages and prices more generally. That is a risk that cannot be dismissed lightly, given the experience of the 1970s when this did indeed happen.”

The third challenge is that greater interdependencies and linkages in the global economy "...have greatly increased the potential for global economic shocks and volatility of various different kinds." Andrew Sentance argues that: "In an ideal world, we would develop stronger international mechanisms for dealing with these potential sources of economic fluctuations ... But the difficulties of establishing and operating frameworks for international co-operation mean that policy frameworks for managing global economic volatility are likely to remain inadequate and imperfect for some time to come. As a result, economies which are very open to international trade and business like the UK are likely to have to live with more economic volatility than we would ideally like."

Andrew Sentance notes that the second two challenges are most directly relevant to the role of the MPC and asks how the MPC should respond to them. He describes the role of monetary policy in helping to stabilise the economy following the global financial crisis and during previous episodes, noting that: "In the future, we may not be able to achieve the high degree of stability for growth and inflation that we saw in the MPC's first decade. But our experience also suggests that we are not powerless to act in the face of significant global economic changes either." He goes on to say that "The price stability objective provides the ultimate benchmark to guide how policy should respond to changes in the economic climate". "...The world inflation climate has become much more inflationary now, both through the direct effect of rising energy and commodity prices and through a turnaround in global demand." It is not correct to argue that inflation generated by import prices is outside the control of monetary policy, Andrew Sentance says: "Monetary policy affects the exchange rate – which in turn can offset or reinforce our exposure to rising import prices. And the demand climate and the price expectations of firms can affect how much of this imported inflation comes through to the consumer."

He concludes by saying that: "Continuing to accommodate inflation makes it more likely that a future sharp policy correction will be needed, particularly if persistent high inflation becomes embedded in wage and price-setting. That not only poses a threat to the recovery further down the track, but it could erode the hard-earned credibility of the UK monetary policy framework – which would be very damaging for economic growth over the longer-term."

Key Resources

The challenges of the 'New Global Economy' – Full speech