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News release

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Monetary policy in a weak economy - speech by Martin Weale

In a speech delivered at the National Institute of Economic and Social Research, Martin Weale – External Member of the Monetary Policy Committee (MPC) – reviews the UK's slow recovery from recession, in particular focusing on the unusual behaviour of productivity and consumption. He goes on to discuss what the Bank has been doing to support the economy before reviewing some of the other proposals that have been suggested.

Martin Weale begins by reviewing historical data in an attempt to understand the UK's difficulty in recovering from the recession which began in 2008. Weale suggests that there are only two factors which appear to help predict the length of time that output remains depressed following a recession: the current account and the occurrence of banking crises. But even accounting for these factors, Weale concludes that the UK's recovery is unusually slow: "...at the outset of the recession output in the UK would have been expected to be depressed below its previous peak for only two years...the central path of the MPC's latest forecast implies that it will probably take five and a half years for output to recover to its previous peak".

Martin Weale continues by focusing on two striking features of our current circumstances: productivity has recovered, but not regained its previous path; and household consumption has been unusually weak. He examines the movements of these two variables and discusses what the connections between them might be, concluding that "...worsened productivity growth is one factor contributing to the weakness in consumption." He also says that an additional explanation of weak consumption in the UK, is that in the middle years of the last decade, consumption was simply too high, sustained only by a continuing willingness and ability of consumers to borrow. Finally, he adds: "...even if weak consumption is an important factor behind the poor performance of the economy, that does not mean that rapid growth in consumption is the only way of sustaining the recovery."

Weale goes on to discuss monetary policy, noting the paradox that policies, such as asset purchases, which support current consumption, probably impede the rebalancing of the economy. However, he says the case for the recent expansion of the MPC's programme of asset purchases "...is that we believe they are required to prevent inflation falling below its target in the medium term...we are trying to maintain a balance between overall demand and supply such that inflation is brought close to its target. From a broader economic perspective, further progress with rebalancing will be easier when normal economic growth has resumed." He adds: "unless the economic situation improves, there is likely to be a strong case for extending the asset purchase programme after the current one comes to an end."

Martin Weale concludes that although the MPC has further scope to use its policy tools, it has no instrument to promote rebalancing specifically, "...current circumstances make clear more than ever that monetary policy is only one part of overall economic policy...Monetary policy cannot, on its own, set the economy on a sound and sustainable long-term growth path." However, Martin Weale asserts that: "something close to normal productivity growth, the driver of our long-term growth in prosperity, will resume in the future" and with it an improvement in living standards.

Key Resources

Monetary policy in a weak economy – Full speech