BANK OF ENGLAND

News release

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Quantitative easing and the economic outlook – speech by Charlie Bean

In a speech to the Scottish Council for Development and Industry in Glasgow, Charlie Bean – Deputy Governor for monetary policy and member of the Bank's Monetary Policy Committee (MPC) and Financial Stability Committee – describes his view of the economic outlook and the actions the MPC has taken to promote the recovery.

Charlie Bean begins by briefly discussing the possibility of Scottish independence. "Whether or not Scotland becomes an independent country once again is a matter for the Scottish people to decide" he says. He adds that, were Scotland to become an independent country, " ... the associated monetary arrangements would then be one of many matters needing to be settled. But the exact form of those arrangements would be for the Westminster and Scottish parliaments to decide, not the Bank of England. Until asked to do otherwise, the Bank will continue to use the powers delegated to us by the UK Parliament to try to deliver, to the best of our ability, monetary and financial stability for the United Kingdom as it stands..."

Charlie Bean goes on to discuss the economic outlook. Although growth slowed at the end of last year, recent indicators of UK growth have been encouraging, he says, and inflation should continue to fall: "that means that the long-lasting squeeze on household real incomes is also starting to ease. In turn, that should facilitate a modest pickup in household spending ... But while growth should gradually strengthen, the continuing headwinds from the unwinding of excessive debt and the Government's continuing fiscal consolidation mean that the pace of recovery is likely to remain moderate by historical standards", with growth expected to "remain sluggish in the first half of the year". "...Domestically generated inflation – presently running around 1½%... – should stay subdued", he argues, and without the additional £50 billion of gilt purchases announced at the February MPC meeting, inflation would have been more likely than not to undershoot the 2% target in the medium term. Moreover, he says, "...the longer capacity lies idle, the more likely it is to be scrapped completely. And the longer people are out of work, the more likely they are to become disconnected from the labour market altogether. So there is an added incentive to getting the recovery back on track quickly."

Turning to the problems in the periphery of the euro area – the "biggest single downside risk" to the outlook – Charlie Bean states "at best, these countries face an extended period of very low growth while the necessary adjustments take place." But "...there still remains a possibility that events could unfold in a disorderly and

damaging fashion..." Such an outcome would affect the United Kingdom via trade and financial linkages, and harm household and business confidence. But there is little the MPC, or the UK Government, can do to influence these events, he argues: "In particular, it would make little sense to set the level of asset purchases so as to try to counteract an extreme event whose likelihood, timing and magnitude we have no realistic way of assessing."

Charlie Bean ends by discussing recent commentary on the effectiveness of the MPC's asset purchase programme, and whether it is having undesirable consequences for some groups of individuals. On the first, he points out that "it is quite possible that the impact of a given quantum of purchases will be different at different times and be sensitive to the prevailing economic conditions. But that is also the case with changes in Bank Rate, where the effects can be equally uncertain." In conclusion, he says "...so far we have seen little to suggest that the effect on nominal demand will be markedly at odds with that of our first round of purchases".

On the second issue, Charlie Bean stresses that "...the current extended period of rock-bottom interest rates has impacted heavily on those holding most of their savings in deposit or short-term savings accounts, who have seen negative real returns. Savers have every right to feel aggrieved at losing out; after all, they did nothing to cause the financial crisis. But neither did most of those in work, who have also seen a substantial squeeze in their real incomes. And unemployment, particularly among the young, has risen as output has fallen... There have been few winners over the past few years." While annuity rates have fallen, he says, "...that is only part of the story. Those pension funds will typically have been invested in a mix of bonds and equities, with perhaps a bit of cash too. The rise in asset prices as a result of quantitative easing consequently also raises the value of the pension pot, providing an offset to the fall in annuity rates. The impact of quantitative easing on those approaching retirement is thus more complex than it seems at first blush."

Charlie Bean concludes by saying: "if we had chosen to run a substantially tighter monetary policy, then that would only have served to depress activity and raise unemployment even further ... it would also make the task of fiscal consolidation and de-leveraging even more challenging. And by providing a gloomier climate for business, it would also inhibit investment and slow the necessary re-balancing of our economy towards manufacturing and internationally tradable services." "The immediate consequences may be unpalatable, but the sooner we can get the economy on the mend, the sooner we can return policy to more normal settings and the better it will be for all of us – savers, businesses and employees alike".

Key Resources

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http://www.bankofengland.co.uk/publications/Documents/speeches/2012/speech546.pdf

Full speech by Charlie Bean