BANK OF ENGLAND

# News release

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## Monetary policy: navigating rough waters – speech by Martin Weale

In a speech delivered at the Hart Brown Economic Forum, Martin Weale – External Member of the Monetary Policy Committee (MPC) – reviews the outturns for inflation and growth compared to the first forecasts he contributed to as an MPC member: growth has been weaker and inflation higher than expected.

In considering the economic weakness that the UK has experienced since the first quarter of 2008, Weale looks at poor productivity performance as a key counterpart. He says that the causes of this weak productivity growth are not known, and that it is impossible to take a view on whether it is supply or demand driven. Weale says that the more important question for the MPC is whether a sharp increase in demand would prevent inflation from falling back to target or not. He states: "I am very doubtful that the productivity ground we have lost over the last four years would be fully, or even largely, recouped if there was a sharp increase in demand in the near term...But it is rather more likely that productivity would start to grow at something like its trend rate if demand were more buoyant and the easing of inflationary pressures reduces the risks associated with this."

Looking at the more immediate prospects for the economy, Weale reflects that the crisis has led to rising costs of bank funding which has added to the squeeze on the domestic environment. He states that: "Our [the MPC's] asset purchases have probably provided some support to the economy, even if it is not clear how much. But they have not had, and could not have been expected to have, the effect of bringing the rates set by banks...much closer to Bank Rate." High interest rates and credit rationing are factors depressing the economy, he says. "If banks could lend more, and do it more cheaply, that could help deliver a more normal pattern of demand growth." On thinking about how to address this issue, Weale says that he shared the view of other Committee members at the June meeting that further monetary stimulus could be applied to the economy without putting the inflation target at risk, but he wanted to wait for the outcome of the discussions between the Bank and the Treasury on possible new measures before he felt able to come to a view on the appropriate stimulus.

Commenting on the new measures, which have since been announced by the Governor, Weale notes that since 2008, monetary policy has needed "more than just a single spanner" in its tool box to be effective in a wide range of circumstances. He suspects that: "pound for pound, the new interventions will do more to support the economy than would deploying the same sums on further asset purchases." Although he is mindful that policy makers need to recognise that the distinction between monetary policy, fiscal policy, regulatory policy and macro-prudential policy is no longer clear-cut.

Weale concludes that the Bank and the Treasury have taken important steps to provide extra monetary support for our financial system and thus the economy as a whole. He considers that the easing of inflationary pressures means that there is much less risk of above target inflation becoming entrenched than had seemed the case only a few month ago. In turn, he says, that "there is appreciably more room for further monetary stimulus." Finally, he notes that "It would be too much to expect that all of this will deliver a calm sea and a prosperous voyage; there is only so much that can be expected of monetary policy and that is especially true in the current international environment of high uncertainty. But it will certainly help."

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