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The UK's economic recovery: why now; will it last; and what next for monetary policy? - speech by Spencer Dale

Speaking at the Confederation of British Industry (CBI) East of England Midwinter Lunch, Spencer Dale, Chief Economist at the Bank of England considers three key questions about the economic recovery: why now; will it last; and what next for monetary policy?

Spencer attributes the recovery partly to improved availability of credit. He has seen a "marked improvement in the ability of many companies and households to access credit over the past 18 months….aided by domestic policies including the Funding for Lending scheme, a series of regulatory actions to improve the strength and resilience of our banking system and, more recently, the Government's Help-to-Buy policies". In terms of credit supply to SMEs "there's further to go …but we have taken a step in the right direction." For households, the improvement in credit availability has been more marked. As a result, "there's been some thawing" in the housing market.

Spencer argues that "a healthy housing market is good for our economy and will help to support the recovery" – underpinning an increase in house building, allowing people to move more easily, and supporting consumer confidence. He cautions that "the UK housing market has a … microwave type quality to it, with a tendency to turn from lukewarm to scalding hot in a matter of a few economic seconds". But he argues that the Bank is "far better equipped to respond to these types of risks than in the past".

Dale suggests that reduced economic uncertainty has probably played an even more important role in turning the economy around this year than the availability of credit.   "Uncertainty and fear greatly amplified the … impact of the financial crisis". "Companies faced with a more uncertain outlook adopted a defensive strategy, hunkering down to ensure they survived the economic storm". They held off "undertaking new investments or starting new ventures". But the "cloud of uncertainty has started to lift" which should "provide a powerful spur to the recovery". In particular "reduced uncertainty and increased spending by both households and companies becomes self-reinforcing … and can amplify the recovery".   Furthermore, this "virtuous circle may be enhanced by the benefits reduced uncertainty can have for the supply side of our economy". "Companies may lift the shutters and start to take the types of risks and entrepreneurial activities necessary for our long-run prosperity".

Overall, "there are good reasons for optimism that the recovery will persist,.. but we can't take it for granted." Dale cautions that the "events of the past few years may colour and contaminate business behaviour for many years". In particular, he suggests that "the reluctance today of some companies to borrow from their banks may be less a lack of demand and more a breakdown of trust", which adversely effects "the efficient functioning of our economy."

Turning to monetary policy, Spencer emphasises the MPC's forward guidance is "rooted in the recognition that it's a long way back to the economy being fully recovered. The damage and losses associated with the financial crisis ….won't be reversed by one or two quarters of strong growth." The message to businesses is clear, Spencer contends: "You can plan for the future in the knowledge that the MPC intends to keep interest rates low until we've seen a prolonged period of strong growth, unemployment is significantly lower, real incomes are higher."

Spencer's best guess is that such conditions for raising rates remain "some way in the distance". But once they are met, and rates start to rise, "…we should see [this] as a sign of the strength of our economy. As a sign that that we are well on the way to making a full recovery. As a sign that the emergency life-support measures put in place since the crisis are no longer required." "The MPC is fully aware that extraordinary low interest rates are likely to be needed for some time yet. But when they cease to be, this will be a sign that we have finally turned the corner for home."

Spencer concludes that "the journey back to full recovery is long and many challenges still remain. Monetary policy is there for the long haul. That is the essence of forward guidance."