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The UK economic outlook - speech by Charlie Bean

Speaking at the Society of Business Economists Annual Conference, Charlie Bean – Deputy Governor for Monetary Policy – discusses whether the pickup in UK growth is likely to be sustained, and considers the impact that forward guidance has had on interest rate expectations.

On growth prospects, Charlie suggests that there are "at last signs that the recovery may be gaining traction" after a long period where growth has been disappointing. The main reason to believe that the resurgence in growth will be sustained is that two important factors that have been holding back growth are now acting less as a headwind. UK banks "have made considerable progress in bolstering their capital positions…. [and] are now well placed to provide the credit necessary to support recovery". And "the euro area is no longer in existential crisis". Nevertheless, Charlie warns that "the pace of recovery is likely to remain fairly modest by historical standards". In part that reflects the likely effects of planned fiscal consolidation, in part weak spending by some households with high debts, and in part residual uncertainty of businesses about the sustainability of the recovery.

On the impact of forward guidance, Charlie believes that "businesses have got the message that the MPC will only begin to tighten policy once the recovery is entrenched". He also sees some evidence that households pushed back expectations of interest rate rises after forward guidance was announced.

He notes that bond yields have "risen substantially since May" but warns that "interpreting movements in market rates is complicated" because they are influenced by many factors. In particular, Charlie notes that "the recent run of UK data has been unusually strong relative to market expectations". And he shows that in recent months, upside surprises have been stronger in the UK than in the US or euro area. "Market interest rates should therefore have been expected to rise, and by more here than in the other two jurisdictions". Furthermore, Charlie shows that in the past, the slope of the UK yield curve has been strongly correlated with movements in indicators of growth (such as the Purchasing Managers Index). But more recently the yield curve has steepened "by far less than similar episodes of rising growth in the past would suggest. This too may be an indication that the guidance has had some effect in preventing unwarranted movements at the short end of the yield curve."

Charlie also discusses how sensitive UK yields have been to recent developments in the US. He concludes that “there is mixed evidence …on whether guidance may have helped to de-couple movements in short-term rates from those overseas.” On the one hand, UK short run yields have been highly correlated with US short term yields which Charlie suggests might mean that “market participants may have not yet grasped the extent to which decisions over the level of Bank Rate will be driven by the domestic outlook”. But on the other hand, the response of UK short term rates to US data surprises appears to have declined recently, suggesting that some de-coupling with the US has taken place.