BANK OF ENGLAND

News release

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From Lincoln to Lothbury: Magna Carta and the Bank of England

This evening, in a speech at Lincoln Cathedral to mark the 800th anniversary of Magna Carta, the Governor of the Bank of England, Mark Carney, will set out his views on the monetary policy outlook for the United Kingdom

The Governor will reiterate the MPC's intention to return inflation to target in a sustainable manner within two years. That means setting Bank Rate to eliminate the remaining slack in the economy, bringing about the sustained increase in costs necessary to achieve overall inflation of 2 %. He expects that this will involve raising Bank Rate over the next three years from its current all-time low of ½ per cent.

The Governor will note that it would not seem unreasonable to expect that once interest rate normalisation begins, increases in Bank Rate would proceed slowly and rise to a level in the medium term that is perhaps about half as high as historical averages. The Governor will add that, in his view, the decision as to when to start such a process of adjustment will likely come into sharper relief around the turn of this year.

The Governor emphasises, however, that the path of interest rates is much more important than the precise timing of the first rate increase, and that several important considerations mean the actual path almost certainly will not be mechanical, linear or pre-determined. Shocks to the economy and shifts in the exchange rate, for example, could easily adjust the timing and magnitude of interest rate increases. Given these considerations, the MPC will have to feel its way as it goes, and there is a wide distribution of possible outcomes around any expected path for Bank Rate, reflecting the inevitability that the economy will be buffeted by shocks and that monetary policy will have to adjust accordingly.

The Governor reflects on the enduring legacy of Magna Carta, agreed by King John in 1215. At its most idealised, Magna Carta makes clear that power derives from the people and constrains the authority of the state. The state can in turn devolve power – to regions – and to independent bodies. But these bodies can never forget from where their power came or to whom they are responsible. Their authority is constrained to that necessary to pursue specific objectives and they are accountable to the people for their performance.

Magna Carta's core institutional legacy – namely the importance of delegated authority, with clear lines of public accountability – is at the heart of the Bank's institutional arrangements, with power flowing from the people via Parliament within carefully circumscribed limits. That independence, in turn, demands accountability in order that the Bank commands the legitimacy it needs to fulfil its mission.

Direct quotes from the speech:

"The MPC's intention is to return inflation to target in a sustainable manner within two years. That means setting Bank Rate to eliminate the remaining slack in the economy, bringing about the sustained increase in costs necessary to achieve overall inflation of 2%."

"I expect that this will involve raising Bank Rate over the next three years from its current all-time low of ½ per cent. The need for Bank Rate to rise reflects the momentum in the economy and a gradual firming of underlying inflationary pressures – a firming that will become more apparent as the effects of past commodity price falls drop out of the annual inflation rate around the end of the year. It also reflects the lags in monetary policy, given the peak impact on inflation of a given adjustment in interest rates is likely to materialise around 18-24 months after the change"

"The Bank of England is around half a millennium younger than Magna Carta. To put the limited and gradual expectation in historical context, short term interest rates have averaged around 4½ per cent since around the Bank's inception three centuries ago, the same average as during the pre-crisis period when inflation was at target. The average pace of tightening in tightening since the adoption of inflation targeting in 1992 was around 50 basis points per quarter."

"It would not seem unreasonable to me to expect that once normalisation begins, interest rate increases would proceed slowly and rise to a level in the medium term that is perhaps about half as high as historic averages. In my view, the decision as to when to start such a process of adjustment will likely come into sharper relief around the turn of this year.

"That said, the path is much more important than the precise timing of the first rate increase. And I am conscious of several important considerations which mean the actual path almost certainly will not be mechanical, linear or pre-determined. First and foremost, shocks to the economy could easily adjust the timing and magnitude of interest rate increases. Second, the largest cumulative tightening in the UK since inflation targeting was adopted was 1½ percentage points, compared to an average cycle of 3 percentage points for the US Federal Reserve over the same period. This likely reflects in part the greater sensitivity of UK household balances sheets in the medium term to floating interest rates, something that could be particularly relevant in our still heavily indebted post-crisis economy… …We will learn more about the importance of these sensitivities as interest rates increase. Third, developments in the exchange rate have been important for UK inflation and activity, and in particular we have experienced persistent exchange rate pass-through to headline inflation. This risk is particularly relevant at present when the monetary policy stance of our largest trading partner is diverging with ours."

"Most fundamentally, there are broader macroeconomic considerations, particularly the UK's large external imbalances. With the largest current account deficit in the advanced world, the right policy mix leans towards tighter fiscal, more accommodative monetary and tighter macroprudential policies."

"Given these considerations, the MPC will have to feel its way as it goes…. …There is, in fact, a wide distribution of possible outcomes around any expected path for Bank Rate, reflecting the inevitability that the economy will be buffeted by shocks and that monetary policy will have to adjust accordingly."

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