Report to the Treasury Committee

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A. Economic and monetary developments and voting record

1. The conduct of monetary policy over the period since my appointment to the MPC (and completion of the associated TSC questionnaire) can be split into three phases: exit from the period of exceptional monetary policy support implemented to address the pandemic; response to the inflationary impulse stemming from higher energy prices following Russia's invasion of Ukraine; and management of monetary policy through the episode of financial market turmoil that took hold late last September.

2. As I re-joined the Bank staff and became a member of the MPC in early September 2021, the Committee was being challenged by the emergence of inflationary pressures not seen for some time. In the first instance, these stemmed from the interaction between a shift in global consumer demand away from consumer-facing services towards durable goods, and disruption to the global supply chains that produce those consumer durables. Both of these phenomena found their origins in the Covid pandemic, the resulting lockdowns and the dislocations they implied in production, spending and transport.

3. The combination of stronger demand and weaker supply led to the emergence of bottlenecks in international durable goods markets, which increased the price of those tradable goods at the global level. As a price taker on global markets, the UK imported these price increases: the MPC forecast an increase in UK CPI inflation to levels around 5%, largely owing to higher imported goods prices.

4. In order to steer inflation back to target, these inflationary pressures required a monetary response, all the more so as the highly supportive monetary policy stance established in the face of the pandemic – with Bank Rate at 0.1% and gilt purchases in progress – then remained in place.

5. The need for a monetary policy response was exacerbated by the increasing tightness of the UK labour market, as the recovery from the pandemic continued apace. Global demand patterns and supply chains were expected to normalise as the pandemic receded, as indeed has proved to be the case, albeit more slowly than we assumed at that time. But the danger existed that higher inflation

could become self-sustaining and thus persist even as the original inflationary impulse receded if so-called second round effects became embedded in UK price, wage and cost setting behaviour.

6. On this basis, I voted for a progressive tightening of UK monetary policy in my first MPC meetings: in September 2021, I supported the retirement of the forward guidance that has signalled interest rates would be kept at their effective lower bound; in November, I supported the decision to halt the MPC's asset purchase programme started in March 2020 and subsequently extended; in December, I supported an increase in Bank Rate to 0.25%, which has been followed by further increases at each of the subsequent MPC meetings to date; and in February 2022, I supported a start being made to the MPC's programme of Quantitative Tightening (QT), via a cessation of the reinvestment of the proceeds of maturing gilts in its bond portfolio accumulated as a result of QE, as well as sales of corporate bonds.

7. By nature, these decisions were taken on the basis of the information and data available at the time, and my analysis and assessment of them in that context. With the considerable benefit of hindsight, I now recognise that I probably underestimated, at least to some extent, the complexity of global supply chains, and thus the duration and intensity of the inflationary pressures that resulted from their disruption by the pandemic. Moreover, waiting for official labour market data to confirm whether the end of the Coronavirus Job Retention Scheme ('furlough') would ease recruitment difficulties and contain the wage and cost pressures that threatened to generate inflation was probably an overly conservative approach on my part, given other indications of labour market tightness at that time, including from intelligence from the Bank's Agency network. I have drawn lessons for analysis and interpretation from these episodes.

8. That said, my emphasis at that time – which I would maintain today – was that the withdrawal of monetary policy accommodation should be clearly flagged, measured and resolute. Given the lags in monetary policy transmission and the unavoidable uncertainties in interpreting the data flow from one month to another, it is the direction of the policy shift away from the period of exceptional support as well as the steady-handed character of subsequent adjustment of the policy stance that mattered most. This was reflected in my support for the first Bank Rate increase in December 2021, even in the face of the uncertainties created by the emergence of the Omicron variant of Covid at that point.

9. The size and pace of this steady-handed adjustment in the monetary policy stance was challenged by the emergence of new and significant additional threats to price stability in February 2022, which followed from Russia's invasion of Ukraine and its implications for commodity prices, especially energy and food prices. In particular, given the UK's reliance on imported natural gas for heating and electricity generation, the rise in European wholesale gas prices following from Russia's

restriction of supply to Western Europe in the aftermath of the invasion implied higher UK CPI inflation.

10. This inflationary disturbance exhibited a number of important characteristics. It was a genuine shock, in the sense that it has not been anticipated more than a few months in advance. It had a rapid impact on UK CPI inflation (the measure targeted by the MPC), owing in large part to the direct effect of wholesale gas prices on household energy bills. And it was large: from the day I re-joined the Bank to its peak at end-August 2022, the January 2023 European natural gas price future rose more than tenfold.

11. Taken together, and recognising the inevitable lags in monetary policy transmission, these features of the energy price shock imply that significant upward volatility in UK inflation was inevitable following the invasion of Ukraine, since even an immediate monetary policy response to the invasion could not have entirely offset its impact on UK consumer prices. The key question was whether that volatility could be limited to the shorter term or would leak into more long lasting deviations from the inflation target.

12. Furthermore, since the UK is a net importer of natural gas, the large rise in European wholesale gas prices caused a significant deterioration in the UK's terms-of-trade. Simply put, the price of what the UK was buying from the rest of the world had risen substantially relative to what the UK was selling to the rest of the world. This implied an unavoidable squeeze on the UK residents' real spending power, which weighed on domestic demand, even as UK inflation rose. At shorter horizons, such shocks present a trade-off for monetary policy: bringing inflation back to target more rapidly through aggressive monetary tightening would magnify the slowing of domestic demand. But the consequences of such real shocks for national income are ultimately unavoidable: in the end, monetary policy cannot avoid the need for real adjustment, but can only help make the transition less costly.

13. Managing this transition was further complicated by the unanticipated continued tightness of the UK labour market. Contrary to expectations as the furlough scheme ended, through the turn of the year and into the spring of 2022 the UK labour market remained tight, with vacancies rising to historical highs and unemployment falling to below pre-pandemic rates, even though aggregate economic activity was yet to regain its end-2019 level. The tight labour market (together with persistently strong corporate pricing power in still disrupted supply chains) constituted an environment susceptible to the emergence of second round effects in UK price, wage and cost setting behaviour, which in turn threatened to generate some self-sustaining momentum in UK inflation that would persist even as the original inflationary impulse from higher gas and food prices dissipated.

14. This unexpected labour market tightness had its roots in a deterioration in labour market participation. UK labour supply has fallen, owing to a combination of longstanding demographic effects and stronger rates of early retirement and long-term ill health (which may have the origins in the pandemic). Changes in the character and volume of immigration following Brexit are also likely to have contributed. While some of these factors are likely to have generated offsetting changes in demand, overall it is likely that the net effect of these developments has been to exacerbate and extend the tightness of the labour market, thereby intensifying the risk of second round effects.

15. In this context, I supported a continuation of monetary policy tightening during the spring of 2022. I also supported the acceleration of that tightening from the summer as the threat of a more persistent dynamic in UK inflation became apparent in a variety of indicators: the strength of private pay growth, the increase in services price inflation, and reports of recruitment difficulties from the Agency network.

    From March 2022 to date, I have voted for a cumulative increase of 350bp in Bank Rate. Moreover, in September I voted for a stepping up of the MPC's QT programme through starting sales of gilts held in the bond portfolio the Bank had accumulated as a result of Quantitative Easing (QE).

    In sum, these measures represent a substantial adjustment in the monetary policy stance, which I now view as restraining rather than supporting demand and therefore serving to contain the additional inflationary pressures that have emerged over the past year.

16. Both the MPC's QT programme and its broader programme of monetary policy tightening were challenged by the onset of financial market turmoil in late September 2022. In particular, in line with the arrangements governing the implementation of QT announced by the MPC, the Bank chose to postpone the introduction of QT gilt sales in the face of market dysfunction that emerged in that period. Owing to the subsequent stabilisation of markets following the Bank's implementation of financial stability operations in the gilts market, the QT gilt sales programme was able to commence in early November, and is on track to achieve the contraction in the stock of gilts held as a result of QE in line with the MPC's September 2022 policy announcement.

17. The character of the financial stability operations has been reported to the Treasury Committee on other occasions. As a member of the Bank Executive team, I have been involved in and supported the design and implementation of those operations. From my perspective as an MPC member, this episode demonstrated both the importance of the MPC's independence in formulating monetary policy and also the need for rich information flows among the Bank's policy committees and with the Bank Executive.

18. The MPC needs to retain sufficient control over monetary policy instruments to ensure it can achieve the inflation target. Financial stability operations should not compromise this. In the recent

episode, this was ensured by those financial stability operations being temporary and targeted, such that they do not have a lasting impact on the monetary trends that ultimately determine inflation.

19. I have been strongly supportive of the MPC's efforts to monitor whether the financial stability operations meet this criterion. That monitoring has been exercised through scrutiny of developments in the sterling money market, in the risk-free sterling yield curve, in wider asset market developments, in the character of the financial operations themselves (including the unwinding of gilt holdings in the Bank's asset purchase facility, which was completed in January 2023), and in the large flows both into and out of broad money seen through and in the aftermath of the market turmoil (which broadly net out overall). These efforts have been reported in the MPC minutes. Thanks to the considerable efforts of my colleagues in the financial stability and market operations areas of the Bank with whom I have worked closely and cooperatively throughout this episode, I am confident that the financial stability operations have supported monetary policy transmission in a very challenging environment, without prejudicing the independence or capacity of the MPC to achieve its remit.

20. More generally, the events of late September and early October 2022 demonstrated the importance of the institutional framework for UK macroeconomic policy in supporting and sustaining good economic outcomes. Mutual respect for the independence of the bodies involved is at the heart of that framework.

B. The economic outlook

21. Following its meeting on 1 February, the MPC published a new *Monetary Policy Report*, including its latest economic forecasts. While these forecasts represent the 'best collective judgement' of the Committee as a whole – and thus not necessarily my personal view in every detail – they nonetheless broadly correspond to my own assessment of the economic outlook at present.

22. In particular, as regards the inflation outlook, on the basis of the available data I expect headline inflation to fall significantly in the course of 2023, in large part reflecting the very large increases in energy prices seen last year dropping out of the calculation of annual inflation rates. We have already seen headline inflation ease a little. The substantial fall in European wholesale gas prices of late supports the view that the original source of inflationary pressure last spring is now receding.

23. As reflected in my previous remarks, the key question is whether second round effects in price, wage and cost setting behaviour threaten to impart a self-sustaining momentum to UK inflation as the initial impetus coming from external sources dissipates. The continued tightness of the labour

market, strength in private sector pay growth and high rate of services price inflation all point to caution in assuming such momentum is absent.

24. But we are now seeing some signs of loosening in the labour market data: vacancies are falling, and some leading indicators of wage developments are easing. The slowing in economic activity seen in 2022 H2 is working its way through into the labour market, while also reducing corporate pricing power. In line with the latest MPR forecast, I would expect some margin of economic slack to emerge that serves to contain inflationary pressures. Moreover, having raised Bank rate significantly over the past year, there is substantial further monetary policy tightening still to come through as a result of lags in policy transmission. That should weigh further on inflation in the coming years and bring inflation back to target.

25. That said, there is no room for complacency. Inflation remains unacceptably high. Returning inflation to target in a sustainable manner requires that the MPC continues to be watchful for signs of greater persistence in inflationary pressures than is embodied in our baseline forecast.

26. As regards UK economic activity (and again in line with the MPC's latest forecast), I anticipate an extended period of weakness. Whether this entails recession or anaemic growth or an alternation between the two will depend on quarter-to-quarter volatility that is difficult to forecast. The economic slack that weighs on inflation explains part of the weakness of activity, but this needs to be seen against a weak outlook for the productive potential of the UK economy, owing to the adverse effects of persistent low investment, weak labour supply and low productivity growth.

C. Communication of monetary policy and other MPC-related external engagement

27. Since I joined the MPC, I have made a number of public speeches outlining my view of the economic conjuncture, the outlook for monetary policy and strategic issues related to the design and conduct of monetary policy. These are listed in the Annex. Also recorded in the Annex are the Agency visits, the Citizen and Community Panels with the public, and the school talks I have made over the past year.

28. In addition to these efforts to engage with various public audiences, I have also regularly been interviewed on business media after MPC policy announcements. In concert with the Bank's Outreach programme and its Economy Hub, I have engaged in webcast discussions with the public following the August and November 2022 MPC meetings. (A further webcast is scheduled for 6 February 2023.) I have participated in panels at various forums for market participants, notably in the midst of the market turmoil last September. And I have been active as a speaker or chair at a variety of academic conferences on core monetary policy issues both inside and beyond the Bank.

Annex: List of public speeches and other external engagements

Date	Speech	Venue
09/01/2023	UK monetary policy outlook	Money Market Association of New York University, New York
23/11/2022	Monetary policy and central bank asset purchases: Substitutes and complements	Beesley Lecture, Institute of Directors, London
12/10/2022	Monetary policy: An anchor in challenging times	Scottish Council for Development and Industry, Strathclyde University, Glasgow
29/09/2022	Recent developments in the economy and markets	Institute of Directors NI Annual Dinner, Holywood, County Down *(pre-recorded speech)*
07/07/2022	Economic outlook	Sheffield Hallam University, Sheffield
06/07/2022	Returning inflation to target	Qatar Money Centre annual conference, Kings College, London
24/06/2022	What did the monetarists ever do for us?	*Walter Eucken Institut, Stifung Geld und Wahrung*, Freiburg, Germany
20/05/2022	The economic situation and monetary policy	ACCA Cymru, Cardiff, Wales
09/02/2022	Monetary Policy with a steady hand	Society of Professional Economists, Virtual conference
26/11/2021	UK Monetary Policy – 'Crossing the river by feeling the stones'	Confederation of British Industry, Newcastle-upon-Tyne

Engagement	Details
Citizen Panels	3 (Southampton, Belfast *virtual*, Edinburgh)
School visits	3 (Birmingham, Northampton, Swindon)
Press Interviews	10 (on and off record)
Regional visits	8 (North East, South Central, Wales, West Midlands, Scotland, East Midlands, Greater London, South West)