
The prospects for monetary stability

The Governor welcomes⁽¹⁾ the Government's clear restatement of its objective of permanently low inflation as the essential contribution that monetary policy can make towards achieving steady and sustained growth of output and employment over the medium and long term. He looks at recent international and domestic developments which are part of current policy judgments, and concludes that there is a real opportunity to make a decisive break-through to permanent stability.

It is a fact of modern life that all of our financial institutions are today subject to continuous external, as well as internal, scrutiny. That is no doubt how it should be. It ensures that we remain on our toes and keep up with the times in the new world of global financial competition. But it should not be allowed to obscure our successes. The facts are that £12 billion in new equity was raised through the Stock Exchange last year—twice the average of the previous four years; the Stock Exchange last year had turnover of £300 billion in domestic equities—twice the level of four years earlier; and London has a higher proportion of international equity trading than any other centre anywhere in the world. I should like this evening to congratulate the Stock Exchange on that success which I am sure will continue.

On this occasion last year, My Lord Mayor, I was able to report to your predecessor that the British economy was in its third year of expansion and that, for only the fourth time since 1970, the rate of growth in the preceding year had exceeded the rate of inflation. I can do better than that this evening. The economy is now into its fourth year of expansion; and we have now had two successive years over which output has grown faster than the rate of inflation.

And I can report to you too that the impetus to expansion over the past year has come from net external trade and to a lesser extent from investment—which augurs well for the sustainability of the expansion—and that unemployment has fallen in each of the past 21 months to almost the lowest level among the major countries of Europe.

The question now, My Lord Mayor, is can we keep this very encouraging performance going?

I don't pretend that it is all plain sailing. On the side of inflation, we have had to contend over the past year or so with a strong adverse tide in the form of higher international commodity prices and an associated increase in input costs to UK producers. There are some signs that this tide may now be beginning to turn. Nevertheless the short-term pressure on producer output prices, and hence on retail prices, remains strong; and it is likely to be aggravated by the fall in the exchange rate earlier this year, after two years

of relative stability. Now there is not in fact much that domestic monetary policy can do directly to protect us from these unwelcome developments. But nor can we simply ignore them. Up until now, the cost pressures have been substantially contained by tight control over domestic labour costs and by a reduction in profit margins, particularly on domestic sales. The important concern for policy is to ensure that we do not now begin to see them feeding through more rapidly and setting off the all too familiar spiral of domestic inflation.

How far we can prevent that, looking ahead, depends largely on what happens to overall demand in the economy in relation to productive capacity, and on our monetary policy response. And here the navigational hazard is poor visibility. Looking back, we can be reasonably confident that growth in the economy moderated—as it needed to do—during the course of the past year. But there is some considerable uncertainty as to the current and prospective pace of the expansion. The picture has been complicated for some time by the contrast between the visibly slow growth of demand from the household sector and the buoyancy of the manufacturing sector which has been less widely appreciated. The horizon has been further obscured more recently by doubts about the manufacturing sector itself, with subdued official data apparently telling us one thing and the more robust survey evidence, as well as the current monetary indicators, apparently telling us another.

Poor visibility in these particular waters is not at all unusual, my Lord Mayor. In practice, in the real world, monetary policy judgments are invariably a matter of balancing risks—of weighing probabilities rather than pointing to certainties. However straightforward it may all seem from the outside, those judgments are rarely clear cut. Indeed, given the long lags before policy changes have their full effects, it may be many months before anyone can be confident of the outcome. The Bank certainly lays no claim to divine insight—and nor, I suspect, does the Chancellor.

It is hardly surprising, given the uncertainties, that reasonable people may differ from time to time in the judgments that they make as to precisely what course to

(1) In a speech on 14 June at the Lord Mayor's dinner for the bankers and merchants of the City of London.

steer. The really remarkable thing would be if they always agreed. Indeed that would raise doubts about the credibility of the process.

What is unusual—and I think almost unique—about the monetary policy process in this country is not that those involved in that process can arrive at different conclusions; that is true everywhere. It is that, when they do, both the fact and the nature of the difference are quite deliberately made known to the world through the publication of the minutes. I believe that this transparency is a positive aspect of our arrangements. It promotes wider public understanding of the true nature of the process, including understanding of the uncertainties. It makes the Bank publicly accountable for the quality of its advice, as the Chancellor is accountable to parliament for his decisions. And it represents a check or balance within our constitutional arrangements that can, I believe, help to reduce the risk that we are carried very far off course, in either direction.

But what matters even more fundamentally is that our destination should be clear and clearly understood, not just by all those involved in the monetary policy process but by the public at large. The Chancellor has restated the Government's monetary policy objective—permanently low inflation—quite unambiguously this evening. I very much welcome that—not, as I have repeatedly explained, simply as an end in itself, but as the essential contribution that monetary policy can make towards the true final objective of steady and sustained growth of output and employment over the medium and long term.

The Bank of England will give the Chancellor all the support we can to achieving this goal of permanently low inflation—in particular through our independent assessment of progress

towards the inflation target in our quarterly *Inflation Report* and through our independent advice on the policy steps that we judge to be necessary to achieve that target. That is the job we have been asked to do. And it is by reference to the inflation target of 2½% or less—as the Chancellor has confirmed this evening—that we expect our policy advice to be judged.

My Lord Mayor, as I reported at the outset we have made great progress in the past two years towards establishing a more stable economic environment in the United Kingdom. The benefit from this is to be seen in lower inflationary expectations which need nevertheless to fall further to be consistent with our objectives. It is to be seen too in market expectations that interest rates will peak in this upswing at barely half their peak in earlier cycles in the last 15 years. We now have a real opportunity to make a decisive break-through to permanent stability—with all that that means for long-term investment and economic activity. It is an enormous prize. And I look forward to reporting on further progress towards it next year.

In the meantime, My Lord Mayor, let me thank both you and the Lady Mayoress for your most generous hospitality to us all here in the Mansion House this evening. And let me congratulate you both on the way in which you have maintained the best traditions of your high office. You have promoted the financial services of the City of London at home and abroad. You have through your Mayoral theme—the City, Heart of the Nation—helped to ensure that the City's wider contribution to the public good is better understood and appreciated, and you have encouraged the City to play its part in the wider community, for example, through your emphasis on the Lord Mayor's Dragon Awards.