

## Speech at the Northwest Development Agency/Bank of England Dinner<sup>(1)</sup>

*The Bank's Court of Directors (responsible for managing the Bank's affairs, other than the formulation of monetary policy) meets outside of London once each year. In October, Court was held in Liverpool and the **Governor** gave a speech at the Northwest Development Agency/Bank of England Dinner in Manchester on the preceding evening. He spoke about the UK and North West regional economies and identified several key questions confronting the MPC: the sustainability of the gradual global recovery; the prospects for consumption growth; and, how much risk there might be of an abrupt retrenchment by consumers. These are all difficult questions of degree. But the **Governor** concluded that, despite these challenges, 'in terms of the overall economy—including here in the North West, things are better than they've been in a long while'.*

The Bank has excellent contacts here in the North West—as indeed we have throughout the United Kingdom. We've been represented here—both in Manchester and Liverpool—for over 175 years; and I have no doubt that our present resident Agent, Tony Strachan—and his Deputies, Graeme Chaplin and Neil Ashbridge—are well known to many of you. They report regularly each month to the Monetary Policy Committee on the business climate—frequently attending our monthly briefing meetings to tell us face to face what it is you're getting up to. You just can't imagine the tales that they tell! It's not that we don't believe them—but we still feel the need to come and see for ourselves! The members of the MPC and other senior officials of the Bank are regular visitors up here.

But this is the first occasion on which we have invaded you in such large numbers—with ten of our non-executive Directors and all nine members of the MPC plus over a dozen other officials—for a meeting of our Court (or Board) of Directors.

We're here to learn more at first hand from you what things are really like on the ground, and to give you our impressions of the state of the UK economy as a whole.

I don't suppose it will come as a great surprise if I tell you that we bring a somewhat mixed message on the overall economy. And it won't surprise us, either, if you give us the same mixed message about the regional economy. And the reason—at both national and

regional level—is clear. Our overall economic performance has not been at all bad over the past decade. But for the past few years, beneath that relatively calm surface there has been a sustained imbalance, between businesses and sectors that are heavily exposed to some very cold winds blowing in from abroad, on the one hand, and the more domestically oriented businesses and sectors, which have on the whole been doing much better, on the other.

To remind you of some facts. Inflation—on our RPIX target measure—has averaged 2.6% over the past ten years, and has for the past two years been mostly modestly below our 2½% target. But that hasn't been achieved at the expense of consistently high interest rates, and weak growth and employment, as many people feared that it would be. In fact nominal interest rates have been as low they've been for 40 years; the overall economy has grown without interruption quarter by quarter—at an average annual rate of 2¾%, which is comfortably above its long-term trend; the number of people in employment has risen fairly steadily—and is still close to its all-time high, while the rate of claimant count unemployment has fallen from 9.6% to 3.1%—the lowest it's been for more than 25 years.

And what's true for the UK economy as a whole is broadly true for every region of the United Kingdom, including the North West region. Total output in the North West increased year by year from 1992 to 1999—the latest number I have—though at a somewhat slower

(1) Given on 15 October 2002. This speech can be found on the Bank's web site at [www.bankofengland.co.uk/speeches/speeches/speech179.htm](http://www.bankofengland.co.uk/speeches/speeches/speech179.htm)

average annual rate than in the United Kingdom as a whole, at around  $1\frac{3}{4}\%$ .

The number of people in employment in the region rose by about  $\frac{1}{4}$  million from the end of 1992 to over 3.1 million in the past two years. And the rate of claimant count unemployment fell from over 10% to 3.5%—still somewhat above the rate for the United Kingdom as a whole, but again the lowest rate for over 25 years.

But I'm well aware that you don't have to look far beneath the surface to see that at the sectoral or individual business level things are a lot more uncomfortable than these aggregate figures might suggest.

To a degree that's always going to be true. Competition—at both the national and international level—inevitably means the expansion of some sectors or businesses at the expense of others. Yet it is a necessary driver of the increasing economic efficiency and higher sustainable growth rate that we need to satisfy our aspirations for improving living standards. But the stresses we've seen within our economy in the past few years go well beyond normal competitive pressures. For the most part they originate abroad, with, first, the Asia crisis and its aftermath in the late 1990s, happily substantially offset, as far as the United Kingdom was concerned, by strong growth in the United States, but then last year by the sharp, synchronised, slowdown into negative growth in most of the world's major economies.

Although the pressures were not confined to manufacturing, and were not uniform within manufacturing, manufacturing was hit harder than other sectors. Manufacturing output fell from its peaks in the year 2000, to its trough last winter by over 16% in Japan, by  $7\frac{1}{2}\%$  in the United States and by  $6\frac{1}{2}\%$  in Germany. And manufacturing employment fell by  $7\frac{1}{4}\%$  in Japan,  $9\frac{1}{2}\%$  in the United States and 3% in Germany. In this country manufacturing output fell from peak to trough by around 7%, and manufacturing employment by some 6%. So we were not alone in what happened and the impact was not obviously worse than elsewhere. That of course is cold comfort to the manufacturing businesses that were most affected, and to the regions—including the North West, where there is a relatively high concentration of manufacturing business. And you were severely affected last year too by the impact of foot-and-mouth disease on agriculture and tourism.

The frustrating thing for us has been that there was very little that we at the Bank could do through monetary policy—or indeed that the Government could do—to address the problems at source.

That's fairly obvious when we're talking about the weakening of demand in the other major economies. Some people have suggested that we might have done more to weaken the exchange rate—particularly against the generally weak euro—by cutting our interest rates more aggressively, but it really isn't as simple as that: exchange rates don't respond predictably to relative interest rates—certainly in the short term; if anything, in recent conditions cutting them further could even have had a perverse effect.

What we were able to do, given that inflation was under control, by cutting interest rates as we did last year, was to try to compensate for the external weakness by stimulating domestic demand growth here in the United Kingdom. Given the weakness of business confidence, and therefore investment, reflecting the external pressures, that meant essentially stimulating consumer demand.

We recognised that this was not without risks—risks in terms of the build-up of household debt and of an unsustainable rate of increase in house prices, if not an actual bubble—which, if persisted in for too long, or if carried too far, could lead to an uncomfortable retrenchment further ahead. In a virtual world where we could control these things precisely, we could no doubt readily agree that we would like to see stronger growth in other major industrial countries, a stronger euro, more business investment in the United Kingdom and more moderate growth of consumer spending and household debt. That would offer a more certain prospect of better balanced, and therefore more sustainable, growth. But we live in the real world! We expected the global economy to begin a sustained recovery in the latter part of last year which would allow us to return to better balanced growth in this country, and so we took the view essentially that for the time being at least unbalanced growth was better than no growth at all.

In the event, our economy as a whole did just about keep moving forward through the winter, and the global economy—including manufacturing output—bottomed out around the turn of the year. By the early summer both the MPC and financial markets were contemplating

the possibility that we might soon need to act to moderate the growth of domestic demand, if that did not happen of its own accord, in order to accommodate a pick-up in external demand.

But we had not reckoned with the further nervous breakdown suffered by international equity markets during the summer! This seemed to be largely unconnected with developments in the global economy where a gradual recovery—including a gradual recovery in manufacturing output—seemed to be continuing, even if the pace of recovery was slower than was earlier anticipated. In part it no doubt reflected a belated correction of earlier ‘irrational exuberance’ but it seemed to be exaggerated by fears of possible further terrorist attacks following on from 9/11, by a series of corporate governance and accounting failures in the United States, and by the possible implications of war with Iraq. But whatever the causes, the sharp further falls in equity prices have given rise to concerns about the strength of business and consumer confidence, and to doubts as to the sustainability of the global recovery. Internationally, and here in the United Kingdom, both in financial markets and within the MPC, the monetary policy debate has shifted back to the possible need for further monetary stimulus. One helpful consequence of this is that market interest rates have in fact fallen significantly, which will help sustain the recovery.

We find ourselves nevertheless—not for the first time—in something of a quandary.

The key questions confronting us then are:

First—to what extent do we expect the gradual global recovery—which is critical for our manufacturing sector—to be sustained?

Second—depending on the answer to that, to what extent do we expect the consumption growth, that we

have recently been relying upon to keep overall, aggregate, demand increasing in line with our underlying supply capacity, to continue to sustain our overall economy of its own accord?

Third—depending on the answer to that, how much risk—of an abrupt retrenchment by consumers, and a significant shortfall on our inflation target, further ahead—would we be taking, and should we take, by cutting interest rates further now, to sustain consumer demand at the expense of a further build-up of household debt and continuing increases in house prices, in order to maintain the growth of the overall economy?

These are all difficult questions of degree.

But you can be sure that my colleagues on the MPC will continue to monitor both the global and the domestic situation with their usual vigilance—and with an open mind.

There’s no doubt that these are challenging times for all of us. But that should not obscure the fact that in terms of the overall economy—including here in the North West, things are better than they’ve been in a long while. And I am reasonably confident that we will find a way through the macroeconomic, demand management, challenges.

In the meantime there is a great deal that you can do—and are doing—yourselves, here in the North West, under the leadership of the NWDA, in partnership with the other public authorities, the universities, and the private business sector, to identify—on the basis of your local knowledge—the particular obstacles to, and the particular opportunities for, creating a more positive and flexible supply-side environment for the future. In thanking you, Bryan, once again for joining with us in hosting this dinner this evening, I wish you all possible success.