Report to Treasury Select Committee

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Voting record

As in so many other areas of life, the work of the MPC over the past year has been dominated by the Covid-19 pandemic. Its economic effects, including those of the measures necessary to contain its spread, have been extraordinary. The economy contracted by more than a fifth in the first half of 2020, probably as rapidly as it had in over 300 years. The accompanying fiscal measures have pushed public-sector borrowing to levels unmatched in peacetime. And to combat the potentially depressive effects on inflation, monetary authorities everywhere – including, in this country, the MPC – have eased policy aggressively.

It's typical that monetary policy should be eased when growth weakens (and also that the government's deficit should rise) and I have voted for all the various measures – the initial cut in interest rates, the introduction of the TFSME and the successive increases in asset purchases – that the MPC has taken since the pandemic began.

But there are several unusual aspects of this episode to which it's worth drawing attention. First, it's likely that spare capacity in the economy has – so far – widened by much less than the drop in output. Economic activity contracted by almost 8% through the course of 2020 (in the year to Q4), yet unemployment rose by only 1-2 percentage points[1]. Employment typically falls by less than output during downswings, as firms tend to "hoard" labour. But the gap has been much bigger than usual on this occasion, principally because of the furlough schemes. These have prevented what would otherwise have been a much larger contraction in employment. There is, however, a clear risk that unemployment will rise significantly once the schemes come to an end. Indeed that rise has been a constant feature of the MPC's projections throughout the pandemic, which have been conditioned on the announced duration of the furlough schemes at each point in time. The likelihood that unemployment will rise in future, and the disinflationary influence that would involve, has been one of the key factors underlying the significant monetary easing we have put in place over the past year.

Another highly unusual feature of the behaviour of the economy last year was the speed of the swings in output. Normal economic cycles take many years to play out. Last summer the economy recovered almost as rapidly as it had collapsed in the spring (GDP rose 16% in the third quarter). Again, the furlough scheme was very important in this respect, because it interrupted the feedback loop – from output to incomes, from incomes to spending and then back to output – that typically amplifies and prolongs economic cycles. The scheme has acted as a huge automatic stabiliser: GDP may have fallen by 8% in the year to Q4, but real household incomes, in aggregate, are likely to have risen. More fundamentally, the swings in output were rapid because so were those of the pandemic and the associated restrictions. Lockdowns are essentially a

[1] The ONS's Labour Force Survey, the basis for official estimates of unemployment, suggests the rate rose by only 1 percentage point since the pandemic began. But there are some questions about the accuracy of the LFS during the pandemic. HMRC PAYE data, which suggest a larger decline in employee numbers, and which the ONS itself has said may currently be the more reliable guide to those numbers perhaps imply the increase in the rate of unemployment has been twice as large.

cap on economic activity, and once that cap is removed one would expect the recovery to be significantly faster than in any normal economic upswing. That was a feature of the MPC's "scenario" last May, one which drew some criticism at the time. In reality, the bounce in the summer – the economy grew by 16% in the third quarter – was faster than we had envisaged. The same was true in every other advanced economy.

Finally, let me briefly address one thing that has cropped up from time to time this year in respect of our monetary policy decisions, and specifically the expansion in the asset purchase programme. This is the question of "monetary finance". Some commentators have suggested that the APF has been expanded merely to "finance" higher government borrowing and that the coincidence of the two – more debt issuance on the one hand and more QE on the other – somehow proves the point. This is specious. The relevant question is this: what would you expect an inflation-targeting monetary authority, faced with a downturn on this scale, to do? Just as in every other country, and entirely appropriately for an authority tasked with stabilising inflation, the MPC in the UK has eased policy. More generally, it is entirely normal – again in every country, not just this one – to see the monetary stance and the fiscal balance moving in similar directions (up and down together) through the economic cycle. That's not because one causes the other. It's because both are cyclical. Indeed, as I pointed out in a recent speech[2], the capacity to respond to cyclical developments is essential, as far as monetary policy is concerned, to the task of stabilising inflation. Over the past 25 years monetary policy has been more cyclical, and inflation more stable, than over any similar period in British history. Inflation expectations, as measured for instance by the "breakeven rate" in bond markets (the gap between the yields on conventional and indexed debt) have also been stable through this period. There is no indication from bond markets that investors see the MPC's actions as anything other than what has been necessary to meet our primary inflation objective.

The outlook

The current lockdown is likely to lead to another sharp contraction in the economy in the first quarter of 2021. The central forecast in the MPC's latest *Monetary Policy Report*, published earlier this month, was for GDP to fall by 4% between Q4 and Q1. Thereafter the forecast involves a sharp upturn in activity, in line with a presumed and gradual lifting of restrictions from the spring and ongoing vaccination programme. There was some comment afterwards that this was a "stronger" forecast than in November. In terms of the level of GDP that isn't the case. The projected growth rates through the rest of this year are indeed higher than they were three months ago, but only from a level that, following the significant projected contraction in Q1, is quite a bit lower. Despite significant fiscal news in the interim – in November the government announced further increases in planned spending for 2021 – it remains the case, on our central forecast, that the UK economy doesn't return to its pre-pandemic size until early 2022, after the same point for both the US and the Euro area.

[2] Government debt and inflation (2020).

In addition, and in part because the furlough scheme is assumed to close at the end of April (in line with existing government policy), while restrictions still exist, the recovery in demand is expected to be insufficient to prevent a material rise in unemployment – the peak predicted rate of almost 8% is very close to the figure in the previous two Reports in August and November – though that peak is relatively short lived.

The outlook for unemployment is important for underlying inflationary pressure in the economy, and therefore the appropriate path for monetary policy. As I said earlier, the easing in policy in 2020 – the most recent leg of which, the further round of asset purchases, will be conducted through 2021 – already anticipates a significant rise in unemployment and spare capacity through the spring and summer of this year. But there are clearly significant risks around that, not least from the relative timings of the ending of restrictions on the one hand and the closure of the furlough scheme on the other. Those risks are in both directions.

Explaining monetary policy

Since May 2019 I have given five on-the-record speeches:

20.05.2019	Investment and uncertainty: the value of waiting for news
03.07.2019	Financial education and the Bank of England
04.03.2020	Inflation and beliefs about inflation
02.09.2020	Government debt and inflation
12.01.2021	Covid and the composition of spending

On the day of each *Monetary Policy Report*, in addition to answering questions alongside the Governor at the press conference, I host a briefing meeting for private sector economists. During 2020 I also hosted several briefings on the *Monetary Policy Report* for regional Bank of England Agency contacts.

Since May 2019 I have made four physical or virtual regional visits (to Wales (twice), the South East and the North East). These have involved meetings and roundtables with local businesses and events at which I have presented, and taken questions on, the *Monetary Policy Report*. I have also conducted a number of outreach events to schools across the country, though unfortunately I've not been able to do any during the pandemic.

I have given several interviews, including to CNBC, ITV, Telegraph, Sunday Times, Guardian, The Observer, BBC, Financial Times, Sky, and C4. I have attended a variety of meetings and events with City economists and market participants. Finally, as Deputy Governor for Monetary Policy, I have represented the Bank's views in international settings, including the G7, Bellagio, and OECD Working Party No3.