Andrew Sentance: Sustaining the recovery

Speech by Mr Andrew Sentance, Member of the Monetary Policy Committee of the Bank of England, at the British American Business Council in association with RSM Tenon, London, 13 October 2010.

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I would like to thank Tomasz Wieladek and Abi Hughes for research assistance and I am also grateful for helpful comments from other colleagues. The views expressed are my own and do not necessarily reflect those of the Bank of England or other members of the Monetary Policy Committee.

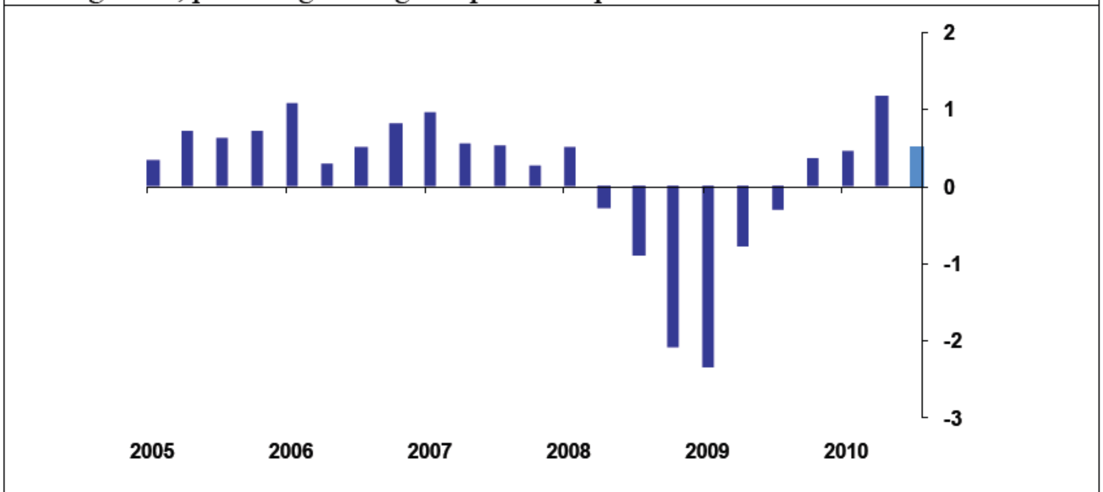
I am delighted to be giving this speech this evening here in the heart of Westminster and I am grateful to the British American Business Council for hosting this event and to RSM Tenon for sponsoring it. As an active member of the Church of England, I am also very pleased to be giving this speech at its headquarters in Church House. The Church of England plays a vital role in supporting the spiritual health of our nation, just as the Bank of England has a key responsibility in underpinning its economic and financial health.

A healthy economy is normally a growing economy. So ensuring the right conditions for a sound and sustained recovery is a key challenge for UK monetary policy at present. And it is that challenge that I want to discuss in my speech to you this evening.

The current recovery in context

The UK economy has been recovering for about a year now. So it is relatively early days to pass judgement on how the current recovery is proceeding. However, the performance of the British economy over the first year of this recovery does provide some grounds for encouragement.

Chart 1: Uneven UK recovery
GDP growth, percentage change on previous quarter



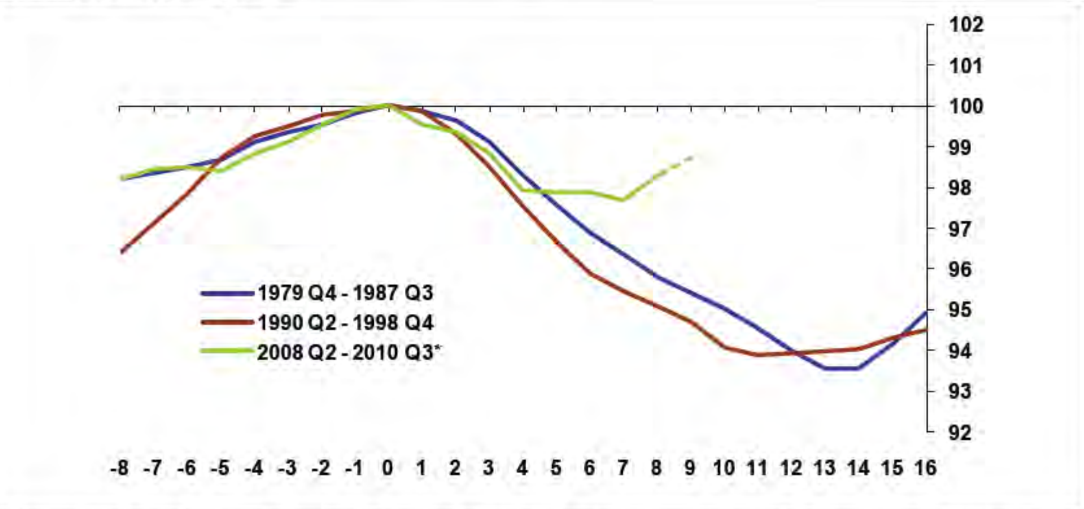
Source: Office for National Statistics and NIESR estimate for 2010 Q3

The recovery has been somewhat uneven. As Chart 1 shows, after a couple of quarters of rather subdued growth at the end of last year and early this year, GDP picked up strongly in the second quarter – producing the largest quarterly rise in GDP for nearly a decade.

We do not yet have an official estimate of growth for the third quarter, but the National Institute of Economic and Social Research estimates that GDP rose by 0.5% in this period. That would produce an annual growth rate of 2.5% for the first year of the economic recovery – in line with the historical average growth trend and somewhat stronger than the rebound we saw in the early stages of the previous two economic recoveries, in the early 1980s and early 1990s.[1] The fact that growth has been uneven from quarter to quarter should not be a great surprise as uneven growth is not unusual as an economy begins to recover from recession.

This return to economic growth must be seen against the background of a sharper fall in output than we experienced in previous post-war recessions. But two more positive aspects of the early stages of this recovery are worth highlighting. First, employment has been more resilient than in past recessions and appears to have turned around more quickly than in the previous recoveries. The total number of people in employment in the UK has increased by over 300,000 since last winter, according to the official Labour Force Survey.[2]

Chart 2: Employment has been resilient
Index relative to peak



Note: 100 = cyclical peak in employment. * 2010 Q3 is based on average June to August 2010 data.
Source: Office for National Statistics and Bank calculations

Chart 2 shows this contrast with previous economic cycles very clearly. Employment is down by not much more than 1% on its level at the peak of the cycle in 2008, compared with a decline of around 5% at the equivalent phase of the early 1980s and early 1990s cycles. This employment picture points to a rather mild recession in terms of the labour market, which contrasts with the much larger fall in GDP relative to previous UK downturns.

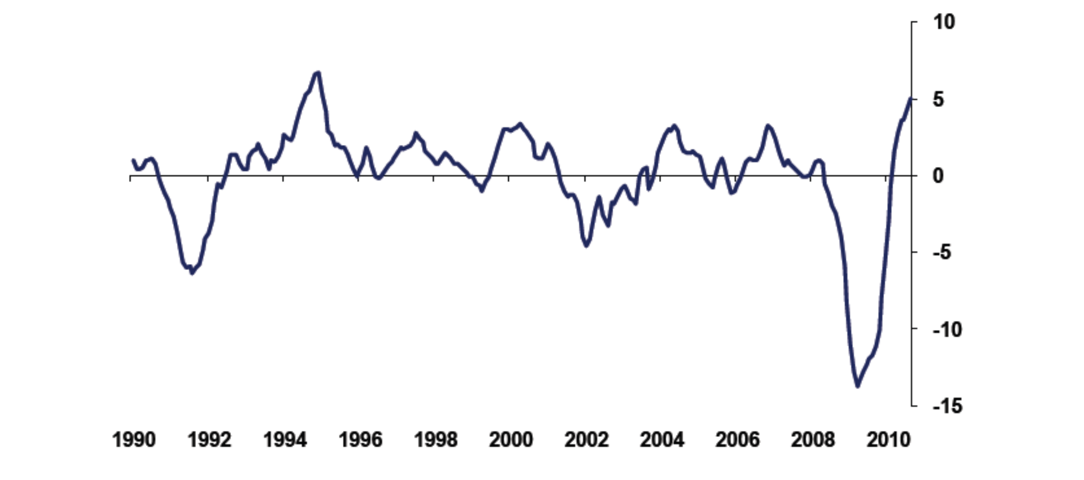
The resilience of employment through the recession should help to sustain consumer confidence. It is also a positive indicator about medium-term economic prospects – as companies would not be retaining and taking on workers if they were not reasonably

[1] UK economic growth averaged 2.5% in the sixty years 1948 to 2008. In the year to 1982Q1, GDP in the United Kingdom grew by 2% and in the year to 1993Q2, it grew by 2.1%. However, if growth is measured from the trough of output in 1991Q3, growth in the first year of the 1990s “recovery” would be just 0.5%.

[2] Between the three months Dec 2009 to Feb 2010 and the period June to August 2010, total employment increased by 315,000 according to the Labour Force Survey.

optimistic about their future business prospects. The recent growth of employment has been driven by the private sector and that should also give us encouragement that the private sector can generate job growth that will more than offset the public employment cuts that may be in prospect following the spending review. I will come back to this point later.

Chart 3: Manufacturing rebounding strongly
Annual growth rate, percent



Source: Office for National Statistics

A second positive feature of the early stages of this recovery is that we have seen some evidence of rebalancing in the UK economy. Manufacturing output is growing much more strongly than the services sector, reversing the pattern of services-led growth that prevailed in the decade before the financial crisis. Over the last year, we have seen the strongest rate of growth of manufacturing output that the UK has experienced in over 15 years – as Chart 3 shows. According to the latest data, manufacturing production is 5% up on a year ago compared with growth of just 1.5% in the services sector over the same period.[3]

While some of this rebound in the manufacturing sector may reflect temporary factors – such as the turnaround in the global stock cycle – it also shows that British industry is able to take advantage of the recovery in the global economy with the additional support of a competitive exchange rate. The ability of British manufacturing industry to provide strong impetus to private sector growth will be an important offset to the drag to domestic demand from the rebalancing of public finances over the next few years. There is also evidence that strong growth in the global economy is benefiting parts of the services sector. Earlier this week, the airport operator BAA reported a 7.6% annual rise in traffic volumes at Heathrow Airport in September – driven by strong business travel growth to Asia and other emerging markets.

From the position a year ago – when demand had fallen sharply at home and abroad in the wake of the financial crisis – this turnaround is impressive. So my verdict on the recovery would be "so far, so good". But we have to recognise that we are still at an early phase of the upswing. It is not surprising, therefore, that growth is uneven across sectors and from quarter to quarter, and that confidence is still somewhat fragile.

The state of confidence is not helped by the negative tone of much of the economic commentary at present – which seems to reflect a high degree of nervousness about the

[3] Data is latest available: for manufacturing it relates to the three months to August and for services to the three months to July.

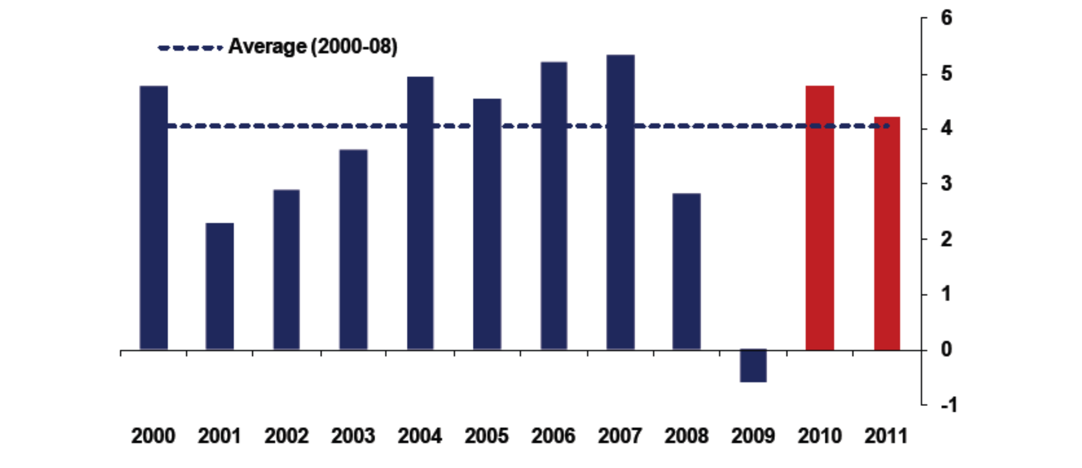
progress of the recovery. But this raises the obvious question: if things are so good, why do they feel so bad – to some people at least?

There are three elements which appear to be underpinning these concerns about the sustainability of growth in the current economic climate: the prospects for the global economy; the prospective impact of the government's fiscal tightening; and the legacy of the financial crisis. I will discuss these three issues in turn before coming back to the crucial issue of how the Bank of England's monetary policy can best support the recovery.

The global economic outlook

A serious setback for the global economy would have major repercussions for the growth of the UK economy. Our economy has a very international focus, and exports, international business activity and the financial sector all play a part in creating strong linkages from the UK to other major economies elsewhere in the world. The sharp drop in business and financial sentiment across international markets in late 2008 and early 2009 – and the ensuing downturn in the global economy – played a major part in tipping the UK into recession two years ago. Similarly, the rebound in the global economy has helped to support our recovery over the last year or so.

Chart 4: World economic growth since 2000
Annual GDP growth, percent



Note: 2010 and 2011 growth rate are IMF forecasts

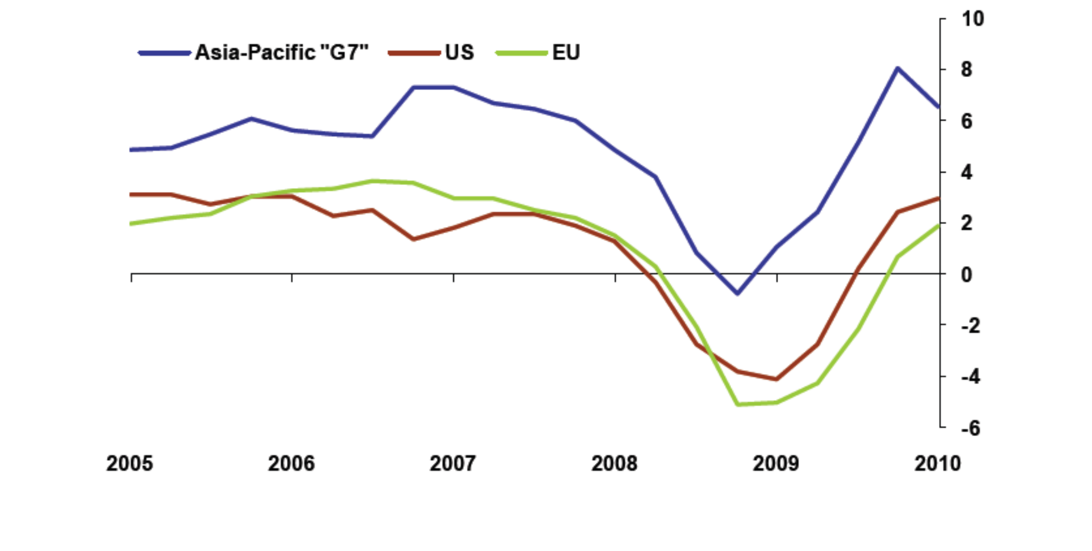
Source: IMF World Economic Outlook, Oct 2010

However, a serious downturn in global growth does not seem very likely at the moment. According to the IMF, global growth this year is now projected to be nearly 5%, compared to a projected growth rate of less than 2% just eighteen months ago.[4] As Chart 4 shows, this is a return to the strong growth rates seen in the mid-2000s, which was regarded at the time as a period of robust growth across the world economy. Though the IMF expects growth to slip back to 4.2% in 2011, this is still above the average global growth rate in the 2000s prior to the recession.

4 The IMF *World Economic Outlook* forecast projected world GDP growth of 1.9% in April 2009. This forecast was uprated to 2.5% in July 2009.

An important driving force behind this global recovery has been growth in Asia and other emerging markets. As Chart 5 shows, annual growth in the seven largest Asia-Pacific economies, an economic bloc on a par with the US and the European Union in economic size, has averaged around 7–8% in the first half of this year, slightly ahead of the pre-crisis rate of growth in this region. Growth in the more mature advanced economies of the US and the European Union has also picked up – though not as strongly as in Asia, reflecting the greater maturity of these economies and hence their lower potential for productivity and labour force growth. In the past year, growth in the US and the European Union has been 3% and 2% respectively. These rates of growth are broadly in line with the trend growth rates we experienced in the US and Europe before the crisis.[5]

Chart 5: GDP growth in major economies
Percentage change on a year earlier



Note: Asia-Pacific "G7" includes Australia, China, India, Indonesia, Japan, Korea and Taiwan

Source: Thomson Datastream and Bank calculations

The latest evidence suggests that the strong momentum of growth in Asia and other emerging markets is being maintained. In Asia, there are many indications that domestic demand has been a powerful driver of its recovery and that growth in this region is becoming more autonomous and less dependent on export demand from the western economies.

In the US and Europe, the indicators are more mixed. Within the European Union, Germany grew very strongly in the first half of this year, recording the biggest rise in GDP since unification in the second quarter and more recently the lowest rate of unemployment since 1992. German unemployment has been falling since the mid-2000s, with the exception of the recession period, which points to an improvement in the structural performance of its economy, which should help to sustain consumer spending and investment. Some of Germany's neighbouring economies – including the Benelux countries – are also sharing in this pattern of healthy growth. A strong performance from these "core" European economies should help to offset the dampening effect of financial and fiscal problems in countries on the European periphery, including Ireland.

5 In the decade to 2007, annual GDP growth averaged 3.1% in the United States and 2.3% in the European Union.

Currently, the United States appears to be in a “soft patch” where growth is disappointing. But the most recent indicators – including the widely followed Purchasing Managers’ Indices (PMIs) – still point to continued growth. Indeed, the latest readings from the non-manufacturing PMI last week showed a surprising pick-up in growth. The latest US data on retail sales and industrial production are also reasonably positive and help offset some of the more downbeat indicators from the housing market. In the US, just as in the UK, we have to recognise that the data may be somewhat variable at this stage of the cycle. We should therefore beware of interpreting this variability in the economic indicators as a sign that the recovery is seriously faltering in the United States, or anywhere else in the global economy.

There is, however, a flip side to the strong rebound we have seen in the global economy since the middle of last year. While the growth of the global economy is helping to sustain the recovery in UK economic activity, it is also putting upward pressure on global energy and commodity prices, along with the impact of a number of weather-related events affecting the supply of commodities. And in a world affected by climate change, we may expect to experience these weather-driven upward price shocks more often.

These upward shocks to UK inflation from import prices – amplified by the relative weakness of the pound – have contributed noticeably to the recent experience of above-target UK inflation. With commodity price inflation running at over 25% annually in sterling terms, a renewed surge in the oil price and evidence that manufacturers’ input costs are picking up again, I believe we are likely to see continued upward pressure on inflation from global price pressures as the recovery in the world economy continues.

Fiscal tightening and financial restructuring

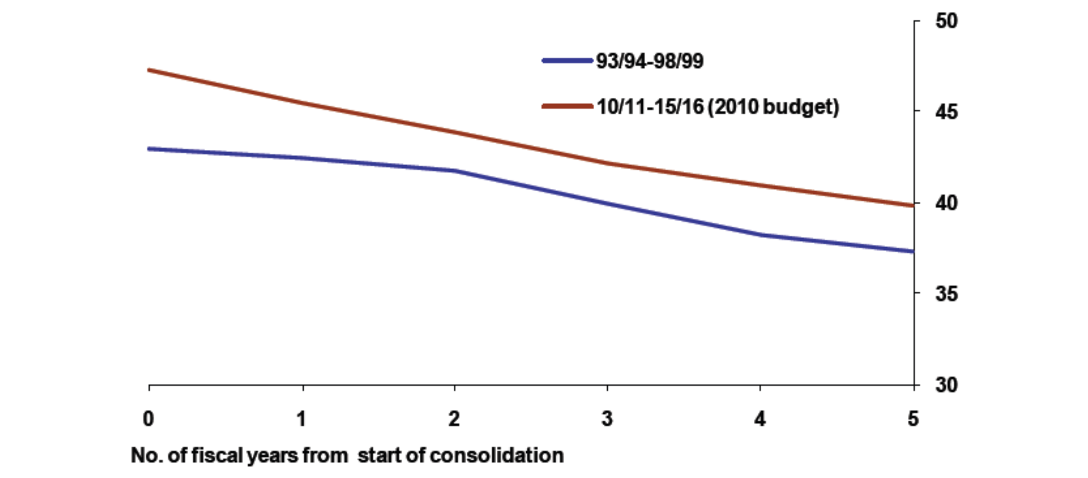
So while we should not rule out further volatility from the global economy, the most likely outcome is that the world economy is likely to provide a helpful backdrop to UK growth, with Asia and emerging markets contributing particularly powerfully, though with the associated risk of more upside shocks to inflation. However, the UK recovery also faces domestic headwinds from the rebalancing of public finances and the continued restructuring of the financial sector. Here too, however, it is important to put current concerns in perspective.

In relation to the prospective fiscal tightening, the first point to make is that the overall public spending plans appear much less draconian than the view projected in the media debate over the summer – when 25% or even 40% departmental cuts were being discussed. Individual areas of public spending may face a significant squeeze to allow growth in areas where commitments to increase spending have been made – such as pensions and health. But taking all these swings and roundabouts into account, the total amount of government spending is still set to increase over the next five years in cash terms. Using the broadest measure, Total Management Expenditure – which captures all areas of public spending, the Budget projects an average spending increase of 1.7% per annum in the five years to 2015/16. Should inflation remain at around the 2% level over the next five years, that would imply that government spending in aggregate is likely to be broadly flat in real terms. While that represents a change from the very significant increases seen over the last decade, it points to a milder drag on growth than some of the more lurid headlines about the spending review have been suggesting.

On the detail for individual spending areas, we will learn more next week following the public spending review that has been going on over the summer. And that will hopefully help to remove some of the current uncertainty around future public spending which has been affecting business and consumer confidence in the UK recently.

A second point to note about the impact of the government’s deficit reduction plan is that all previous recoveries in the UK economy – in the late 1970s and in the 1980s and 1990s – have taken place against a background of fiscal austerity and public spending restraint. It is true that the level of public borrowing has now reached a higher level than in previous downturns – peaking at 11% of GDP, compared to just under 8% of GDP in the early 1990s and 5% in the early 1980s. But the planned reduction in the deficit set out in the Budget plans is comparable with the fiscal consolidation we saw in the mid-1990s, when the public spending share of GDP was also cut significantly as the economy recovered, as Chart 6 shows.

Chart 6: Public Sector Expenditure
Relative to start of fiscal consolidation, percent of GDP



Note: Chart shows Total Managed Expenditure as % of GDP.

Source: 2010 Budget

Though the latest Budget plans imply a somewhat bigger fall in the public spending share of GDP than in the mid-1990s, this is offset by a smaller rise in the tax burden. Taking tax and spending together, the projected impact is broadly similar. Public borrowing fell by over 8 percentage points of GDP between 1993/4 and 1998/9, compared with a 9 percentage point fall projected in the latest Budget over the next five years.[6]

That period of public spending squeeze in the mid-1990s was also accompanied by a significant reduction in employment in the public sector, not dissimilar to the figures currently being discussed in the context of the current spending review.[7] However, the UK economy grew reasonably healthily over that period, with annual GDP growth averaging nearly 3.5% a year in the five years 1994 to 1998. Unemployment also fell because the private sector generated many more jobs than were lost in the public sector. As Chart 7 shows, the private sector created around 2 million extra jobs in the mid-1990s, dwarfing the reduction in public sector employment. The challenge facing the UK economy in the years ahead is to ensure that the private sector can once again become an engine of job creation and growth as the public sector rebalances, repeating the positive experience of the 1990s recovery.

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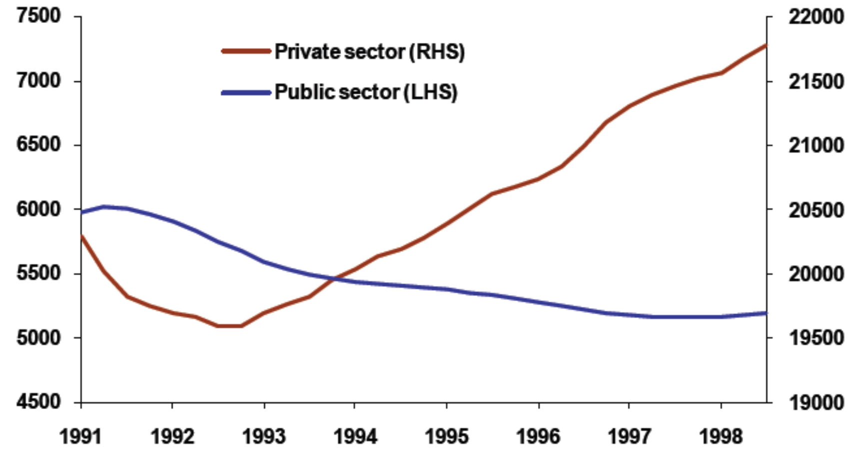
6 Public sector net borrowing was 7.7% of GDP in 1993/4, moving towards a surplus of 0.5% in 1998/9, a swing of 8.2% in the public sector financial balance as a share of GDP. The Budget plans show a 9 percentage point swing – from borrowing of 10.1% in the current financial year to 1.1% in 2015/6.

7 From Q3 1991 to Q4 1998, public sector employment fell by 827,000 – a fall of around 14% of the total. The Office for Budget Responsibility projects a fall in 600,000 over the present consolidation, a fall of around 10%.

Chart 7: Public and private employment in 1990s
Thousands of workers



Source: Office for National Statistics

There is, however, one important difference between the situation now and the mid-1990s in that the flow of finance to support the growth of private sector businesses has been affected by the impact of the financial crisis on the banking sector. For many businesses and individuals, the terms on which they can access lending are much less favourable than before the crisis. In one sense, this is very appropriate in that credit was too freely available in some parts of the financial system in the mid-2000s and this created the conditions for the global credit boom which preceded the financial crisis.[8] But if the pendulum swings back too far and access to credit becomes too restrictive, that could become an impediment to growth over this recovery.

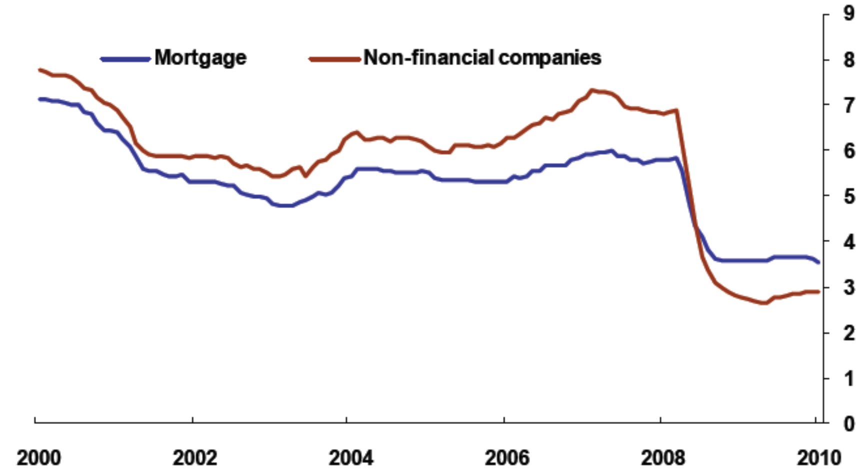
In terms of the cost of funds, monetary policy has provided a powerful offset to any lending constraints. As Chart 8 shows, the cost of mortgage finance for households and the average rate on business borrowing has come down significantly. The current level of interest rates – even allowing for higher spreads on mortgage and business loans – is much lower than those prevailing over the recovery in the 1990s and at the current inflation rate the average loan rates shown in Chart 8 are close to zero in real terms.[9]

There have been concerns registered about access to finance by individual businesses and business groups, though the banks also point out that the demand for new lending is subdued because of the natural caution of businesses about investment at present. In recent visits I have undertaken to businesses around the country, the general picture for manufacturing and services companies appears to be that they can get the finance they need, but it is more difficult and is taking longer and absorbing more management time. Lending related to property and construction appears more constrained, with some of the major banks seeking to substantially reduce their exposure to these sectors.

8 See Hume, M. and Sentance, A., (2009) "The Global Credit Boom: Challenges for Macroeconomics and Policy", Bank of England Monetary Policy Committee Unit Discussion Paper no.27, June 2009.

9 The effective loan rate on mortgages is 3.5% and on business loans 2.9%, compared to CPI inflation of 3.1% at present. In the early stages of the 1990s recovery, bank base rates fell to 5.25% in early 1994 but rose to over 6% at the end of the year. Typical loan rates would be 1-2% above this level.

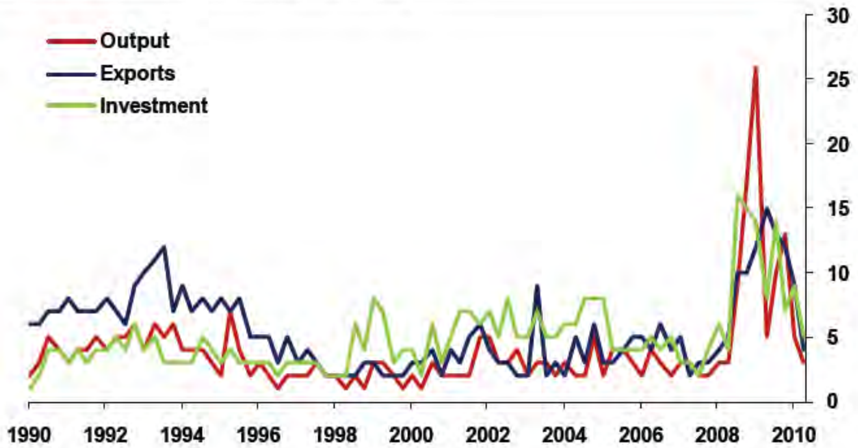
Chart 8: Household and business loan rates
Effective interest rate on loans outstanding, percent



Source: Bank of England

I believe it is an open question on how serious a constraint the financial sector will prove to be on the recovery. But there has been some recent encouraging evidence. Over the last few quarters, the Bank's regular surveys have been pointing to an easing of credit conditions. And the CBI's quarterly Industrial Trends Survey has showed a sharp fall back in the proportion of companies citing access to external finance as a constraint on output, exports and investment. As Chart 9 show, these indicators have returned to around pre-crisis levels from the very elevated and unprecedented levels we saw at the peak of financial crisis in late 2008 and early 2009.

Chart 9: External Finance as a constraint
Percentage of manufacturers: CBI survey



Note: Percentage of firms expecting external finance to act as a constraint on output and exports over the next three months and on investment spending over the next twelve months.

Source: CBI Industrial Trends Survey

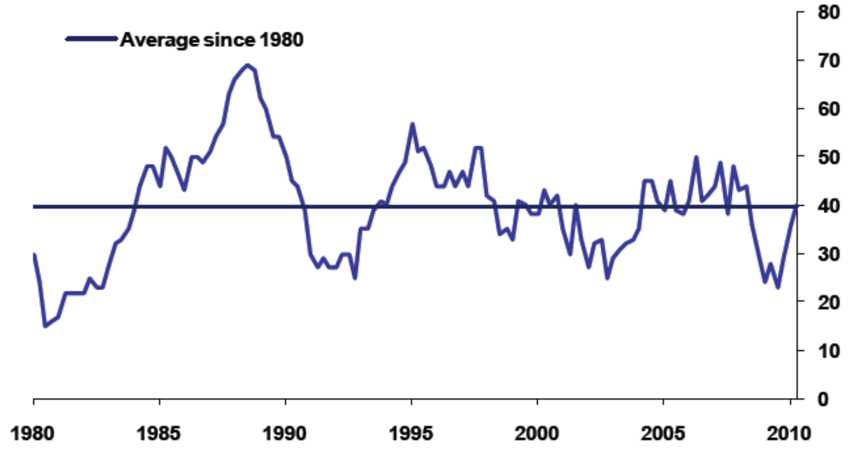
The importance of the supply side

All these factors – the global economy, the impact of fiscal tightening and the effects of the continued adjustment in the financial sector – will have a bearing on the growth of the UK economy through the recovery and hence on monetary policy. But there is another element which is crucial to the progress of the recovery which we need to acknowledge. This is the flexibility and health of the supply side of the UK economy. Key issues relating to the supply-side performance of the economy include: how efficiently labour markets operate; how dynamic and entrepreneurial UK-based firms are; how various forms of regulation affect investment plans and the climate for doing business; and how efficiently the economy can reallocate resources away from declining activities to new areas of growth.

I have been generally impressed by the supply side performance of the UK economy through this recession and the early phases of the recovery. Most businesses have showed resilience in the face of a big shock to demand, and the flexibility of wages and hours worked was used to protect jobs. Company failures have been lower than we have seen in previous recessions.[10] And the economy has turned round from the very worrying situation we faced in the middle of last year and has generated over 300,000 new jobs since last winter, according to the latest Labour Force Survey results.

Chart 10: Capacity utilisation in manufacturing

Percentage balance of firms at or above capacity



Note: Percentage of manufacturing firms reporting that they are working at or above full capacity.

Source: CBI Industrial Trends Survey

But there are some puzzles on the supply side of the economy too, and these have an important bearing on the judgements the Monetary Policy Committee is making at the moment. Capacity utilisation appears quite high given the early phase of the recovery. Chart 10 shows the responses from the CBI's Industrial Trends Survey on capacity utilisation in manufacturing, where it is perhaps easier to assess than in the services sector. Currently, the amount of spare capacity appears to be close to historical averages, which is not what we might expect when the economy is in such an early stage of recovery from recession. This, and other evidence, casts doubt on the degree of spare capacity in the economy and on how significant this factor will be in dampening inflation from its currently elevated level.

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10 Business failures in the recent recession peaked at below 1% of firms, compared with 2.6% in the early 1990s and 1.8% in the early 1980s.

Another puzzle is a surprising drop in productivity we have seen over the recession. Unusually, the decline in output appears to have been much bigger than the decline in employment when normally we observe the opposite result. In terms of the impact on unemployment, this has been a good thing, helping to dampen the cost of the recession in terms of lost jobs. But this raises further questions about how much slack there is in the UK labour market as the economy begins to grow and generate new jobs. The behaviour of productivity in the recession also raises the question of whether the UK productivity growth trend over the medium term has shifted. If it has, we may make big mistakes basing our assessment of underlying growth on past productivity trends.

In my view, these puzzles mean we should be particularly circumspect and cautious at the moment about the assumptions we make about the growth of the supply-side potential of the UK economy and the related issue of the margin of spare capacity. The late 1990s and 2000s saw a wave of supply-side optimism about UK economic performance – but in my view this reflected one-off shifts in labour market performance rather than an improvement in the underlying trend rate of productivity.[11] Given the evidence of weaker productivity growth, it makes sense for policymakers to make relatively conservative estimates of UK medium-term growth potential going forward.

Inflation and current monetary policy

At the beginning of this speech, I said that a healthy economy is normally a growing economy. And that raises the issue of how UK monetary policy should best play its part in sustaining the recovery by contributing to the underlying health of our economy.

Monetary policy can help sustain and support the emerging economic recovery in two main ways. The first is through the impact of the current settings of policy on the growth of demand. It clearly does not make sense to tighten monetary policy dramatically in the current climate in a way which totally undermines the growth of the economy. However, if interest rates were moved up gradually from current levels, in a well-communicated strategy that was understood by the public, the business community and financial markets, the cost of borrowing would still be low in real terms and I do not believe that the recovery would be seriously damaged. Indeed, for the many UK households which rely on the income from savings and investments, this could provide a powerful boost to confidence by signalling the beginning of a return to more normal economic conditions.

The other very important way in which monetary policy can support recovery is by maintaining confidence in price stability over the medium term. The mandate for the Monetary Policy Committee makes clear that the best contribution that the MPC can make to sustained economic growth is by maintaining price stability – which is specified in terms of a 2% target for CPI inflation under our current remit.

There are good reasons why low and stable inflation remains the focus of our monetary policy. The effects of high inflation are damaging in their own right – eroding the value of savings, hitting pensioners on fixed incomes and creating an uncertain and volatile business climate. After inflation got out of control in the UK in the mid-1970s, we experienced two decades of economic volatility and high unemployment, including three major recessions.

Fortunately, there is little risk today of a return to that era of double digit inflation rates. Since the 1990s, the UK's monetary policy framework and the actions of the MPC operating within

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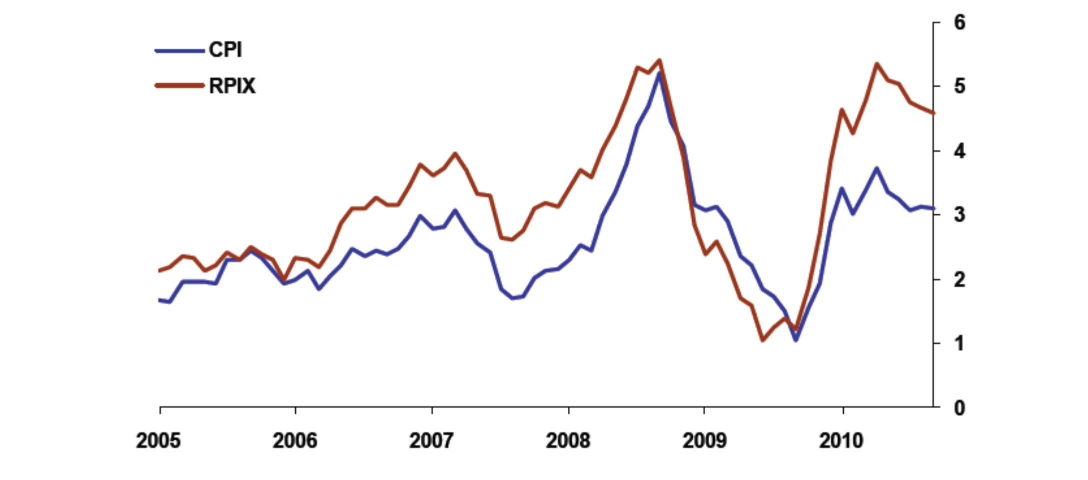
[11] See "Inflation and the Supply Side of the Economy" Speech by Andrew Sentance on 16 January 2007 – my first speech as a member of the MPC, for a fuller discussion of this issue (available at wwww.bankofengland.co.uk). In this speech, I argued that labour supply increases – including a drop in the equilibrium unemployment rate and higher immigration were the main factors leading to improved UK supply side performance between the mid-1990s and mid-2000s.

that framework has built confidence that low and stable inflation will be maintained. But it is important that this confidence is not eroded by a perception that the MPC has taken its eye off the ball and is becoming more tolerant of higher inflation.

Chart 11: Inflation has been stubbornly high
Percentage change, year on year



Source: Office for National Statistics

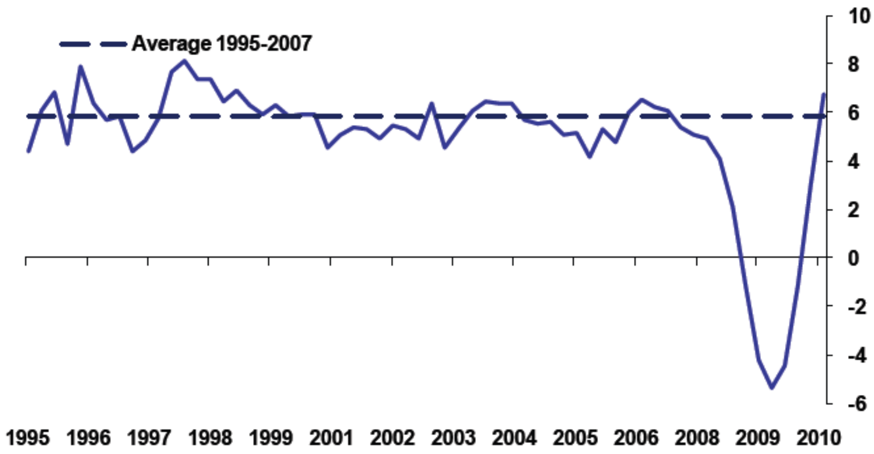
I believe this medium term confidence in a world of stable prices is an important anchor for the private sector when there has been so much instability in recent years. If we continue to experience above-target inflation, while the MPC sets policy to head off the opposite risk – of deflation, confidence in the inflation target and the credibility of the MPC risk being eroded. And the longer the period of above-target inflation goes on without any policy response, the greater this risk becomes.

Unfortunately, the risk of such a loss of confidence and credibility appears to be increasing. As Chart 11 shows, we have seen two major spikes in CPI inflation within the last two years. And it is possible that another one is in prospect when higher VAT comes into effect early next year, particularly if this is accompanied by a continuation of the recent surge in energy and commodity prices. These repeated episodes risk eroding confidence that UK policy-makers remain committed to low and stable inflation, with a knock-on effect on inflation expectations in financial markets, among the business community and the public which could be self-fulfilling.

In the depth of the recession in the first half of last year, we could be fairly relaxed about upward pressures on inflation. At that time, the MPC was worried about the opposite trend – a lurch into deflation with prices and wages on a downward spiral. But these deflationary fears have not been realised. Instead, inflation has run above the target and wage freezes introduced to help businesses weather the storm of the recession are coming to an end. The current period of above-target inflation risks being prolonged by monetary policy which is too lax – creating a climate in which higher inflation is not just the product of one-off shocks but becomes more deeply ingrained.

Chart 12: Nominal domestic demand

Percentage change on a year ago



Source: Office for National Statistics

The economy is now recovering at home and abroad. The world economy is growing above its pre-crisis trend, and domestic spending in money terms is also following the same pattern, as Chart 12 shows. Inflation has been above target, not below it – and is expected to remain so for some time. Because of these changes in economic conditions, I have voted for a rise in interest rates at recent MPC meetings – as a start to a gradual movement away from the exceptional level of monetary stimulus put in place to combat very difficult economic conditions last year. And I continue to believe that this the right policy for the situation the UK economy currently faces.

In the years ahead, we will see much tighter restraint of public spending as the large deficit which built up over the recession is reined in. That process of deficit reduction is necessary to ensure longer term confidence in the future stability of the economy in financial markets and more generally. In this environment, it is the private sector which will be the engine of growth for the UK economy – just as it was in the 1990s recovery and the previous recoveries we have experienced here in the UK. Confidence that inflation is being kept under control is a key factor in sustaining that private sector engine of growth.

My view remains that we should be starting now to make a gradual adjustment of monetary policy. The improvement we have seen in the economy over the last year and the above-target inflation we have experienced point to the need to begin the process of withdrawing the very substantial level of monetary stimulus which was put in place to counter the big financial shocks we experienced in late 2008 and early 2009.

Such a policy should not be a threat to the recovery. In my view it is the key to sustaining the recovery. It is the right response to an economy which is growing but experiencing persistent above-target inflation. It would reduce the risk of a future shock to confidence if current above-target inflation does become more deeply embedded and interest rates then need to rise more sharply to combat it. And it would provide more confidence to the public and the business community that the MPC takes its remit seriously and is determined to ensure that this recovery is built on the solid foundation of price stability.