Mr. George discusses monetary policy, unemployment and economic growth in the United Kingdom Speech by the Governor of the Bank of England, Mr. E.A.J. George, at The TUC Congress in Blackpool on 15/9/98.

Thank you, Chairman. I'm actually very pleased to be here, and to have this opportunity to respond directly to some of the serious concerns that have been expressed recently by Trade Union leaders - among others - about monetary policy.

Let me start with what is perhaps your biggest concern. You think that the Monetary Policy Committee, which I chair and which sets interest rates, is only interested in controlling inflation and takes little or no account of the effects of its decisions on real economic activity and jobs. Some of you evidently think that's because we're a crowd of "pointy-heads" or "inflation nutters", or even "manufacturing hooligans" - and I'm not sure these descriptions are intended as terms of endearment. More seriously some of you think that the problem lies with our remit from the Government which is first, to maintain price stability - defined as an underlying inflation rate of 2½%, and, subject to that, to support the economic policy of the Government, including its objectives for growth and employment.

Whatever the reason, your concern is that we place too much emphasis on holding prices down and not enough on keeping growth and employment up. The implication is that you see a trade-off between inflation and the rate of economic growth, so that if only we'd let up a bit on controlling inflation then this country could enjoy higher activity and lower unemployment, which are the really good things in life - or at least we could avoid some of the worst damage that is currently being inflicted upon the whole of the agriculture, large parts of manufacturing industry and even some services sectors.

And that might even be true for a time. The trouble is that, in anything other than the short term, it would be likely to mean more rather than less economic damage, and lower rather than higher growth and employment.

Often in the past in this country we behaved as if we thought that promoting higher growth and employment - which of course is what we all want to see - was largely a matter of pumping up demand. We paid too little attention to the structural, supply-side, constraints. All too often we tried to buy faster growth and higher employment even at the expense of a bit more inflation. In effect we tried to squeeze a quart out of a pint pot. And you all know the result - rising inflation and a worsening balance of payments, which eventually could only be brought back under control by pushing up interest rates dramatically and forcing the economy into recession. I don't need to remind you of the really miserable social as well as economic consequences - as right across the economy people lost their jobs, their businesses and their homes. More insidiously, repeated experience of boom and bust produced a pervasive short-termism in business behaviour which infected both industry and finance and - dare I say both employers and employees - however much we all like to blame everyone else. Everyone was tempted to grab what they could while the going was good.

But we have learned from that experience. We've learned that in anything other than the short term there really is no trade-off between growth and inflation. What we are trying to do now through monetary policy is to keep overall demand in the economy growing continuously broadly in line with the capacity of the economy - as a whole - to meet that demand. Both the previous Government and the present one set a low inflation target as the immediate objective of monetary policy, not as an end in itself, but in effect as a measure of our success in keeping demand in line with supply. So the real aim is to achieve stability across the economy as a whole in this much wider sense.

Now, there is not a lot, frankly, that we can do directly through monetary policy to affect the supply side - the underlying rate of growth that can be sustained without causing inflation to rise. That can be influenced by the whole raft of Government policies, ranging from education and health to taxation and social security, and it depends ultimately on the ingenuity, the productivity, and the flexibility, of the economy. Employers and employees, working together, clearly have a crucial role to play in this context, and I recognise the constructive and forward-looking role that many of you are now playing to improve the supply-side capacity of the economy.

Monetary policy operates on the demand side. And the best help that we can give is to keep overall demand consistently in line with that supply-side capacity - not letting it run above capacity but not letting it fall below capacity either - as reflected in consistently low inflation. That way we can moderate rather than aggravate the unavoidable ups and downs of the business cycle, enabling steadier growth, high levels of employment and rising living standards to be sustained into the medium and longer-term. And if we can do that, then we will contribute indirectly to the supply side by creating an environment which encourages more rational, longer-term, decision-making throughout the economy.

I would hope, Chairman, that on this basis we could all agree at least on what it is we are trying to do. The debate is not about the ends it is about the means. We are every bit as concerned with growth and employment as you are - as anyone in their right mind must be. But we are interested in growth and employment that is sustained into the medium and long term. And permanently low inflation is a necessary condition for achieving that.

But, even if we agree on the objective, that still of course, leaves plenty of room for us to disagree about what that means for the actual policy stance - the level of interest rates - at any particular time. In fact, as you may have noticed, because we are wholly open about it, even the individual members of the MPC have been known to disagree about that - at the margin. Outside the MPC, a lot of people say to me - “OK I agree we don’t want to return to boom and bust, but you are still overdoing it. From where I sit, or from what I’m told,” they say, “we’re headed for recession - just hours away”. Sometimes they imply by that that we are also going to undershoot the inflation target - sometimes they don’t much seem to care about inflation.

Now there are always plenty of people who claim to know what’s going to happen to the economy, to know that interest rates are “clearly far too high” or “clearly far too low”, and the present time is no exception. It’s been difficult recently to hear yourself think above the deafening noise of opinions on the state of the economy, which, understandably, often reflect the situation in their particular neck of the whole economy wood.

The truth is that neither we, nor they, nor anyone else, can know with any great certainty precisely where demand is in relation to capacity in the economy as a whole. Still less do we know where it is likely to be over the next couple of years - and that is the more relevant consideration, given the time it takes before changes in interest rates have their full effects. Monetary policy is not a precise science - we’ve never pretended that it is. But it can’t be just a matter of sweeping, broad brush, impressions based upon partial information either. What we have to do is to make the best professionally-informed analysis we can, of all the sources of information available to us, relating to every sector of the economy and every part of the country, and then constantly review and as necessary modify our judgements, month by month and quarter by quarter, in the light of the flood of new information as it becomes available.

And that, of course, is exactly what we do in fact do - using the vast array of official economic statistics and financial market data, all the publicly available and some private surveys and commentaries, as well as a wealth of anecdotal and structured survey evidence that we collect

ourselves, through our 16 non-executive directors, through the frequent visits which MPC members make around the country, and through meetings in London, and through our network of 12 regional, information-gathering and disseminating, agencies with their 7000 industrial contacts throughout the United Kingdom. And we openly display the facts as they are available to us, as well as our analysis and our conclusions, regularly through the publication of the minutes of our monthly meeting and in the quarterly Inflation Report.

So when people say to me that the economy is headed for recession, I'm interested in comparing the evidence on which they base their views with our own evidence, and I want to know whether or not they are also saying that they expect us to undershoot the Government's inflation target.

Let's just for a moment turn down the noise and look at some of the relevant facts as they relate to the economy as a whole.

Since the economy started to recover from recession in the spring of 1992 - some 6½ years ago - overall output has grown at an average rate of about 3%. That is well above the trend rate for the past 20 years, of just over 2%. Employment has increased by 1.2 million over this period, while unemployment has fallen almost month by month, on the familiar claimant count measure, from a peak of over 10% in 1993, to some 4.7% now. That is the lowest rate for 18 years. Meanwhile retail price inflation (on the Government's target measure) has averaged around 2¾% - that's the lowest for a generation. There's not much evidence here that low inflation inevitably means low growth and employment.

But, of course, we started this period with demand below capacity - with a fair amount of slack in the economy which we were gradually taking up. By last year it had become clear, in the evidence of rising capacity utilisation and of growing tightness in the labour market, that unless we acted to moderate the growth of demand we were at risk of overheating. That's why we tightened policy over last summer - to slow things down before inflation took off - and to head off a subsequent recession. And although, as I say, you can never be sure - economic forecasting is a very uncertain business - a necessary slowdown rather than a more serious recession is what we think we're seeing, and, as I understand it, that is what your own General Council thinks too.

Our problem in slowing the economy down has been enormously complicated by the increasing imbalance between the domestic and the internationally-exposed sectors of the economy. Domestic demand for goods and particularly for services has been unsustainably strong and large parts of the economy have been doing very well on the back of that. But the sectors which are most exposed to international competition have been suffering enormous pressure as a result, initially, of the exaggerated strength of sterling - especially against the major European currencies in the run up to decisions on the euro; and as a result subsequently of the successive waves of turmoil spreading through large parts of the global economy. Overall demand growth - at least until fairly recently - remained excessive and the labour market has continued to tighten.

The question was what should we do? It was not that we didn't know that large parts of the economy were under the hammer - we have been as conscious of that as anyone. Still less was it that we didn't care - we care, just as you must, about activity and jobs in all sectors of the economy. But the stark choice confronting us was either to tighten policy, knowing that that would inevitably increase the pain which the internationally exposed sectors were already suffering, or to disregard the developing excess overall demand in order to protect the internationally-exposed sectors from further damage.

This second course might have meant less pain for the internationally-exposed sectors in the short run. But it would have meant putting the whole of the economy, including the exposed sectors, at risk of accelerating inflation, and it would in all probability have meant a much sharper downturn in the economy as a whole a little further ahead. We've been round that buoy all too often before. And so we tightened policy, trying as best as we could through our tactics to minimise the unwanted upward pressure on the exchange rate.

I know, Chairman, only too well that this will be cold comfort to many of you in the exposed sectors - but there's no point in pretending things are other than they are. The present imbalance means that we are trying to maintain stability in extraordinarily difficult circumstances.

But I will make one final point. The inflation target we have been set is symmetrical. A significant, sustained, fall below 2½% is to be regarded just as seriously as a significant, sustained, rise above it. And I give you my assurance that we will be just as rigorous in cutting interest rates if the overall evidence begins to point to our undershooting the target as we have been in raising them when the balance of risks was on the upside. There is now evidence that domestic demand growth is moderating, as it must do, and that the labour market is tightening more slowly than before. On top of that, as we said in our press notice last Thursday - announcing that we had not changed interest rates - we recognise "that deterioration in the international economy could increase the risks of inflation falling below the target". That is still not the most likely outcome in the eyes of most of us - and given the real world uncertainties we can anyway never sensibly tie our hands. But there is no doubt in my mind that recent international developments have at least reduced the likelihood that we will need to tighten policy further.