

Mervyn King: Monetary policy developments

Speech by Mr Mervyn King, Governor of the Bank of England, at the Best of the Black Country Awards, Wolverhampton, 16 November 2006.

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The Black Country is where it all began. It began here for me because Wolverhampton is where I grew up. As a boy, I remember the short train trip from Wolverhampton to Birmingham, through the heart of the Black Country, as a journey through manufacturing history. The flames from the blast furnaces lit up the grey sky on winter afternoons. "Black by day and red by night" as the American Consul in the Midlands once described it. Much has changed since then. It has been a difficult time for the Black Country. Many of the companies we visited from school have closed. And the blast furnaces no longer light up the night sky. But the character of the Black Country has enabled the region to come through and enter a new era of regeneration. So I am honoured, and proud, to have been invited to join you tonight.

The Black Country is where it all began – not just for me, but for the British economy. This was a centre of the Industrial Revolution – the first blossoming of manufacturing industry in the world. The coal and iron deposits found here were critical to the Industrial Revolution, and it was the output of nails and bolts, screws and fasteners produced from those ceaseless blast furnaces that made the Black Country synonymous with manufacturing prowess around the world. But that is not the whole story. Just as important were the innate qualities of doing it yourself and perseverance which characterise the Black Country. There is no finer example than the Iron Bridge – the world's first – at Coalbrookdale, built in 1779. As one commentary noted, it stood as "indisputable proof of the abilities of our mechanics and workmen". It reflected not just the local availability of coal and iron, but also the skills of those who built it.

And it is those same skills that we celebrate tonight. Local business success, recognised by these 'Best of the Black Country Awards', is the story of the Black Country being born again. The products of the 21st century may not be the nails and bolts, screws and fasteners of the past, but they will require the use of manufacturing know-how and business ingenuity to service the needs of consumers. I have been struck, as I travel to a different part of the country each month, by how many firms are producing imaginative and innovative products for which there is a real demand around the world. By this I do not mean that all successful firms are making high tech products. Rather, there is a market out there where low wages are not the most important form of competitive advantage. We have seen that in the 'Best of the Black Country Awards', where last year's winners were drawn from the manufacturing, services and construction sectors, and where the winners included both new and established companies. Moreover, the Black Country tradition of numerous small firms operating cheek by jowl is exactly the model so successful in Silicon Valley and Bangalore, in science parks and film studios, and in financial centres around the world.

Of course, some of the old ways have gone, and many manufacturing companies have perished. Recent years have not been easy for the Black Country, especially as profit margins have been squeezed by greater competition from overseas. But there are – as you yourselves demonstrate – many examples of the regeneration of the Black Country, be they new businesses or older ones re-focussing their activities. And the changes underway here are not restricted to the purely economic. The Black Country has seen successes in education, culture and the media. In education, the University of Wolverhampton – impossible to imagine that there would be one when I was a boy – now has over 23,000 students. The University has put its motto – 'Innovation and opportunity' – into practice, through its partnerships with the Wolverhampton Science Park and the Telford-Wolverhampton Technology Corridor. In culture, the New Art Gallery in Walsall opened in its internationally acclaimed building in 1999. And in the *Express & Star*, you have the most successful regional paper in the country.

Sport, too, plays an important role in the life of the Black Country. Next summer twelve schools in the Wolverhampton and Walsall areas will be participating in Chance to Shine – a new campaign to regenerate cricket in state schools, and of which I am proud to be the President. Given that in business the need to work in teams is of the essence, it is sad that competitive team sport in our schools has declined. The aim of Chance to Shine is to give young people from all our communities, boys and girls, a chance to experience – before the world of work – what it is like to be in a team, and

to learn how to win and how to lose. Last summer Chance to Shine enabled almost 50,000 children to play competitive cricket for the first time.

Young people need role models and sport is perhaps the most important source of them. Of the many Black Country sports men and women who have been role models down the years, there is one whom I would like to single out tonight – Vikram Solanki. Born in Rajasthan, Vikram moved to Wolverhampton as a small boy, and became the finest and most exciting batsman to emerge from the area for a long while. Now captain of Worcestershire, one could not think of a better role model to bring communities closer together. That is why I am pleased to say that I shall be one of Vikram's patrons for his Benefit year in 2007.

Of course, I could not talk about sport in the Black Country without referring to football. Nowhere had, in my day, more first division teams within a few miles radius than the Black Country. And all the supporters of those teams have had many opportunities over the years to learn how to win and, especially, how to lose. But for the sake of local interest and rivalry, I am looking forward to the day when Wolves and the Albion are restored to the Premiership.

Just as football needs a referee, so does the economy. I think of the Bank of England's Monetary Policy Committee – the MPC – as the referee for the economy. The MPC sets interest rates to keep inflation on track to meet the 2% target. We want to allow you to focus on running your businesses – you are the players – while the MPC quietly gets on with its job. You may have seen in the news that yesterday the Bank of England published its latest *Inflation Report*. That set out our view on the prospects for the economy over the next couple of years. Perhaps I could briefly summarise our latest analysis of the UK economy.

For the past year GDP has grown at a rate around its long-term average. Inflation has picked up and has been above the 2% target since May. Overall, the central view is one of inflation rising further above the target in the near term, before falling back to the target. The risks around that benign central view are seen by the MPC as broadly balanced, but there is significant uncertainty about the outlook for inflation.

The outlook for growth remains one of a continued modest rebalancing of demand, with consumer spending growing at close to its long-run average rate, business investment continuing to recover, and net trade making a small positive contribution to growth.

The MPC judges that assessing the margin of spare resources in the economy is unusually difficult at present. Capacity utilisation within companies, as measured by surveys, has risen. Although unemployment has risen further, it is difficult to know how much of the rise in unemployment actually represents increased slack in the labour market.

Over the past year or so, the labour force has grown rapidly, following strong migration from Eastern Europe and elsewhere, and a rise in participation rates. There is, of course, great uncertainty about the scale of migration which has clouded estimates of the supply capacity of the economy. Moreover, it is difficult to know how far migration affects demand for goods and services as well as supply. So the overall impact of migration on inflation in the medium term is unclear.

Against a background of firm growth and a limited margin of spare capacity, and with inflation above the target, the MPC judged last week that an increase of 0.25 percentage points in Bank Rate was necessary to keep CPI inflation on track to meet the target in the medium term. So that is where we are now. Where will interest rates go next? I do not know. And the reason I do not know is that we do not take our decisions in advance, but wait to see how the economy unfolds and then take our decisions one month at a time.

The Black Country is where it all began. But now we must look to the future. The Black Country has entered a new era. And you are making it happen. I have explained how the MPC sees the prospects for the economy. If we can retain the degree of stability that we have seen now for more than a decade, then you will have the opportunity to start and expand businesses that will compete for Black Country business awards in the years to come. The winners tonight are shining examples, and I know you are all looking forward to finding out who they are.

It has been a pleasure to come back to where it all began for me. And, whether or not you are one of the lucky few to win an award tonight, I wish your business every success.