Report to the Treasury Select Committee  
Dr Adam Posen, External Member, Monetary Policy Committee  
25 November 2010

Voting Record

I have participated in and voted at 15 monthly MPC meetings since my appointment to the Committee, starting in September 2009.

At the September and October 2009 meetings, I voted to maintain Bank Rate at 0.5% and to continue with the £175 billion Asset Purchase Programme which had been initiated before I joined the Committee. At the November 2009 meeting, I voted to increase the size of the Bank’s Asset Purchase Programme to £200 billion, as well as to maintain Bank Rate at 0.5%. At that time, the impact of the global financial crisis on the UK banking system was still evident, the economy and total employment were still contracting, and the degree of uncertainty about the economic outlook here and abroad was very high. The annual CPI inflation rate was rising, but from a low of 1.1% in August 2009, and was below the 2.0% target. Looking forward, I believed that there were very high risks to the downside for inflation over the medium-term, given the extent of financial fragility and the lack of evident recovery (including in either global trade or UK exports). Thus, I believed that expanding monetary stimulus was the right policy setting in order both to have inflation meet the target as a central forecast, and to do our part to forestall downside risks coming to pass.

From December 2009 through August 2010, I voted to maintain those policy settings unchanged. Over this period, the UK economy moved into recovery, and headline CPI inflation went from 1.9% to a high of 3.7% (in April 2010) at an annual rate, before declining but remaining above target. Unemployment thankfully stopped rising at a level lower than expected, given the depth of the recession. Over time, UK manufacturing exports picked up strongly. Overt financial distress also subsided, in the UK financial system and globally, in part due to measures undertaken by the Bank of England. I decided it was on balance safe to hold off on any further changes in monetary policy in either direction until the nature of the British economic recovery became clear. In

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particular, my assessment of two issues would largely determine my future votes: first, whether the persistent increase in inflation was due to past price-level shocks, or to an ongoing process susceptible to reversal by monetary tightening; second, how large and lasting the impact of the Bank’s Asset Purchase Programme (aka QE) proved to be, beyond it being broadly stimulative.

By September 2010, I had come to believe that the mildly but persistently above target inflation the UK economy experienced was almost entirely due to the combination of the depreciation of Sterling prior to January 2009 and the increase in VAT in January 2010. As a committee, our forecast underestimated the size and particularly the persistence of these inflationary effects, and I accept my share of responsibility for that mistake. That said, annual inflation as measured in the CPIY series, which excludes the price effect of indirect taxes, has been below target throughout this calendar year, so if we allow for some exchange rate effect as well, underlying UK inflation has stayed well below target. Yes, British households do suffer from increases in consumption taxes and in import costs – but that is a decline in their purchasing power due to one-time factors that is neither amenable to reversal through monetary policy nor going to feed a more general rise in prices and wages. I came to believe as well that the expansionary impact of our QE policy was insufficient and diminishing over time, with one indicator being that inflation outcomes net of Sterling’s depreciation (prior to QE) and of the VAT increase were well below target, leaving little price movement attributable to QE.

Given ample spare capacity in the economy, growth exceeding potential for only part of the last year, low wage settlements, unemployment barely declining, and stable medium-term inflation expectations on all financial market and most survey indicators - and absent evidence that underlying inflation was trending upwards, or that QE to date had done too much - starting in September 2010, I forecast inflation to be well below target (after the January 2011 VAT increase is absorbed). Consistent with that forecast, I voted in October and November 2010 to increase the Asset Purchase Programme by £50 billion.

The Outlook

My forecast for inflation to fall well below target through the medium-term remains unchanged from that which underlay my last two votes, for the reasons given above. In addition, I have made a
pessimistic forecast for private consumption growth for two reasons: first, given UK household balance sheets and income, and my estimate of the size and duration of QE’s impact, I expect the household savings rate to rise by around 2% of GDP in coming months and stay around that 4.5% level; second, given the composition and size of the planned fiscal consolidation over 2011-12, I expect a substantial minority of British households’ consumption to contract materially, with little positive offset absent further monetary ease. As a result, I expect both GDP growth and CPI inflation to be significantly lower than the MPC’s mean or mode forecasts published in the latest Inflation Report, assuming no change in our policy.

Explaining Monetary Policy

Over the last 14 months, I have made visits and presentations to businesses, universities, chambers of commerce, and local organizations in several areas of the United Kingdom, including Barking and Dagenham, Belfast and Newry, Coventry and Warwickshire, Durham and Newcastle, Glasgow and Edinburgh, Greater London and East Anglia, Humber and Yorkshire, Lincoln and Skegness. I have given seven formal speeches and several interviews to British newspapers. I have also published over a dozen op-eds and short articles, and met with investors in Sterling-denominated assets from all over the world.