29 August 2023

Annual Report to the Treasury Select Committee

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This report covers the period since I joined the Monetary Policy Committee on 9 August 2022.

Economic Developments & Policy Votes over the Past Year

When I started as an external member, the UK economy was experiencing a terms of trade shock unprecedented in the history of the MPC. There were consequently few episodes to learn from, particularly because the nature of the global economy and the domestic labour market have changed dramatically since the last big terms of trade shocks in the 1970s.

My votes have reflected my analysis of the current inflationary episode, recognised the lagged transmission of monetary policy, and sought to balance the two-sided risks to achieving our target. Despite the international factors that ignited the inflationary episode, it was appropriate for the Committee to increase Bank Rate from its very low levels to a moderately restrictive limit. This guarded against upside risks to inflation, and dampened domestic inflationary factors, albeit with a significant lag.

The turning point in CPI inflation was a pivotal moment, at which stage I voted to pause our tightening cycle. In this respect, I differed from the majority of the Committee. I think a smoother policy trajectory, that avoids sharp peaks and troughs over time, provides a more balanced transmission of policy to households and firms. While increases in Bank Rate intensify its impacts on currently exposed subsets of the economy, incidence and impacts of policy take time to broaden and cumulate. As the effects of policy tightening build, international pressures on CPI inflation are continuing to ease and domestic activity remains weak. There is a growing risk of over-tightening, which heightens the key challenge of appropriately timing a future shift in policy.

September 2022

At the September meeting, I voted to increase Bank Rate by 25bps, rather than 50bps as voted for by the majority of the Committee. Continued pressure on consumer prices, with annual CPI growth around 10%, required further incremental tightening of monetary policy. I based my decision for a smaller increase on three reasons: a worsening outlook for activity, a turning point in producer price inflation, tentative signs of loosening in the labour market, and the lagged effects of monetary policy on inflation. The outlook for GDP and consumption growth was weak, despite the recently announced Energy Price Guarantee, as higher import prices continued to hurt households directly and indirectly through supply chains. Firms were starting to experience a turnaround in output and input producer price inflation, and inflation expectations were starting to fall in the near term. Vacancies – both in absolute terms and relative to unemployment – were falling from their peak. This was expected to reduce upward pressure on wages, albeit with a lag.

Given that monetary policy also affects the real economy and price growth with a lag, a smoother path was more appropriate, as the effect of tightening to date continued to build. Increasing by 25bps would achieve a stable transmission of tight policy, while reducing risks damaging already weak supply capacity at the policy-relevant horizon (approximately 12-24 months for substantive effects).

November 2022

At the November meeting, I voted to increase Bank Rate by 50bps. With inflation much above target, there was also significant market turbulence following the government's fiscal announcements. Actions taken by the Financial Policy Committee allayed the associated financial stability risks, and enabled the MPC to continue its focus on delivering price stability over the medium term. The upside risks to CPI inflation from fiscal measures, market stress and geopolitical uncertainty justified further tightening of monetary policy.

However, I did not support the larger increase (75bps) voted for by the majority of the Committee, due to the worsening outlook for activity and lagged effects of monetary policy. Mortgage rates had sharply increased, further weakening household consumption, and GDP growth had fallen into negative territory. Given the accelerating pace of the Committee's tightening cycle, only around a fifth of its impacts on inflation and around half on output had materialised, based on Bank estimates. We needed to balance near-term pressures against significant drags on consumer price growth at the policy-relevant horizon.

December 2022

At the December meeting, I increased my focus on the risk of over-tightening. It became clearer that consumer price growth might be turning, albeit from a rate far above target. International factors were critical. I estimated that eight out of the ten percentage points of CPI inflation were caused by increases in energy and intermediate input prices, analysis which was developed further with microdata in my first speech.

While it had been appropriate to normalise Bank Rate from its pre-crisis lows, I deemed that it was sufficiently tight to guard against upside risks to CPI inflation for various reasons, including from the buffer of accumulated savings built during the pandemic having been largely eroded in real terms. I voted to hold Bank Rate at 3% in order to avoid suppressing already-weak activity to below target-consistent levels at the policy-relevant horizon.

February 2023

At the February meeting, the outlook for inflation was less severe. A milder winter had led to lower wholesale utilities prices and less supply disruption, partially unwinding global supply shocks.

Despite concerns about firms not passing on cost-savings to consumers, there was little evidence of broad-based margin building. The remaining challenge for CPI inflation targeting was from wage growth. However real wage growth had been negative, suggesting that this episode of cost-push inflation was not de-anchoring wage growth in ways that would fail to unwind after subsequent rounds of price-setting had partially accounted for the rise in the cost of living.

I voted to hold Bank Rate at 3.5%, prioritising a smoother path for policy at a restrictive level, while seeking to mitigate the risk that we suppress activity too much at the relevant horizon.

March 2023

At the March meeting, an upside surprise in CPI inflation was balanced against downside news to the inflation outlook. Twelve-month CPI inflation fell from 10.5% in December to 10.1% in January but then rose to 10.4% in February. However, financial conditions had tightened following the failure of Silicon Valley Bank. Wage growth had come in lower than expected and the extension of the energy price guarantee was directly easing price pressures. There had been an uptick in economic activity but it did not suggest a rise in excess demand, rather an unwinding of the supply shock.

I voted to hold Bank Rate at 4%, given that the outlook had not worsened, and to allow time to analyse recent developments. Responding to monthly data on volatile components came with risks when forming judgements about underlying inflation.

Given the lagged effect of policy on wages and employment, I maintained my view that waiting for these indicators to fully cool before easing the pace of tightening would be a costly strategy. Job-to-job flows had abated and new recruitment wage growth had started to cool, while public sector pay settlements had also not built in broad-based indexation to inflation. A prudent strategy would therefore have been to maintain our current policy stance whilst we produced another forecast, ready to respond to what we would learn about external and domestic developments in price evolution.

May 2023

At the May meeting, there was increasing evidence that inflation would decelerate, and accordingly there was a higher threshold for further tightening policy, given Bank Rate was already in restrictive territory. I worked with Staff to analyse the signals from producer price inflation (PPI), which had fallen steeply. Output PPI inflation in goods had fallen by 11 percentage points, from 19.7% in July 2022 to 8.7% in March 2023. Services PPI inflation had also continued to fall from its peak of six months earlier. This indicated reduced pressure on consumer prices, which was likely to lower consumer price inflation over the year.

I voted to hold Bank Rate at 4.25%. This would insure against upside risks to CPI inflation, such as from food. However, the transmission of monetary policy was likely to be slower than in previous cycles, due to the large stock of fixed-rate mortgages. Agency intelligence and survey evidence indicated that firms anticipated the pass-through of policy to build over time. Further increases in Bank Rate, as voted for by the Committee, came with a higher risk of over-tightening.

June 2023

At the June meeting, my focus was on the gradual easing of inflationary pressure and the risk of overtightening. In my June speech, I developed the analysis of producer price growth and showed its tight historic relationship with CPI inflation. Re-weighting producer price series at the product level with weights of the consumption basket provides an aggregate PPI that better reflects the composition of the CPI basket. This re-weighted PPI series shows a very tight relationship with CPI over the recent inflationary period, with the turning point in PPI occurring about 6 months before that of CPI.

Importantly, the tight co-movement in consumer and producer price inflation was broad-based across the consumption basket. Following ONS methodology, I mapped each product item in the consumption basket to its producer price and consumer price indices. 72 out of the 83 products in the consumption basket (that make up 88% of the basket in value terms) had already experienced a turning point: both producer price inflation and consumer price inflation had been dropping in each of these products.

I voted to hold policy at 4.5%. This was already restrictive of economic activity for the reasons mentioned above. The Committee's majority decision to increase Bank Rate further heightened the intensity of policy tightening and shortened the window over which policy would need to be held and eased subsequently.

August 2023

At the August meeting, three factors informed my decision. First, producer price indices strongly indicated a downward trajectory for CPI inflation. Over 96 percent of the consumption basket in value terms, compared to 88 percent at the previous meeting, had already experienced a fall in producer and consumer price inflation. This included services. The remaining four items (out of 83) that had not turned were volatile agricultural products.

Second, wage growth was highly concentrated in specific sectors. And, overall pay pressure was likely to ease according to many forward-looking indicators. Total weekly earnings for business services increased by 11.3% in the three months to May, relative to a year ago. The business services sector consists of three services in the official data: Information and Communication, Professional, Scientific and Technical activities, and Administrative and Support Service activities. They explained about 3.2pp – or just under half – of economy-wide wage inflation from a sector that makes up about a fifth of the workforce (or only 3 out of 24 industries in the UK economy). In my view, it was not clear that this would trigger further broad-based wage growth in other sectors or further demand-pull inflation, given that these sectors tend to employ higher-earners with lower marginal propensities to consume. Wage inflation across all other industries had been 5.3 percent, implying a continued fall in real wages and expected to slow down further as the labour market continued to loosen.

Third, demand remained weak. Upside surprises to demand – associated with a milder winter, slowing energy price inflation and with reduced economic inactivity – had been sufficiently accounted for by the MPC's recent tightening cycle. Yet despite these welcome surprises, consumption remained weaker than last year and below 2019 levels.

The Economic Outlook

Uncertainty clouds the outlook for activity and inflation. Economic forecasts and market expectations of future policy evolution, such as the OIS futures curve, can be informative of magnitudes of various policy options. But, they are highly contingent on assumptions that they are conditioned on and often come with large forecast errors. Even in normal times, the market-expected rate is neither an accurate prediction of the future, nor necessarily the optimal path for achieving our target. Assessments of market participants and external forecasters have shown much volatility and often little agreement on even the direction of whether the economy has been in excess demand or supply. Leading indicators can be informative in periods of high uncertainty. However, it is important not to be too sensitive to short-term movements, otherwise this can create volatility in policy and activity, making it harder to return to target sustainably. Consequently, my policy decisions have been based on various pieces of evidence regarding the evolution of inflation.

In terms of developments in the global economy, supply has significantly recovered over the past twelve months and the terms of trade shock continues to unwind. Insofar as this trend continues, international pressures on CPI inflation are likely to continue to ease. Prices of commodities – especially energy and food – and intermediate inputs will remain important to the evolution of UK inflation. Another shock, for instance due to geopolitics or extreme weather, could push up on UK consumer price growth. It will therefore be important to monitor indicators further up the supply chain, including international, wholesale and producer prices. As I have argued in my recent speeches, we need to continue developing our statistics and analytic methods to ascertain these supply chain price signals.

Domestic factors are likely to continue to ease the pressure on CPI inflation, especially as housing costs through rents and mortgages cumulate. There is not yet evidence to suggest firms will seek to increase their margins, particularly as output producer price inflation has been falling. While weak demand is likely to reinforce this view, it remains an area where measurement poses significant challenges. The labour market continues to ease as the Committee's recent hiking cycle takes effect with a lag, gradually pushing up on the unemployment rate and down on the V/U ratio. Wage growth remains an area of further inquiry, but it is a lagging indicator and one of the last outcomes to be impacted in the transmission of monetary policy to the real economy. As noted above, recent data indicates pockets of strong wage growth, but a broader picture of falling or stagnating real wages. As the terms of trade shock unwinds, a deferred pass-through of level changes to wages would not necessarily pose a risk to our target in the medium term. I will continue to focus on the composition of wage growth, as well as the headline figures – which should give a clearer sense of the outlook.

The MPC has raised Bank Rate sharply in a short span of time. Policy is already sufficiently restrictive, and the lagged effects of further tightening pose serious risks of output volatility in order to make a small dent on inflation. While each additional increase in Bank Rate intensifies the effect on currently exposed subsets of the economy – for example those rolling off fixed-rate mortgages - it takes time for the breadth of the effects to increase. The duration of our restrictive stance is important, and I have argued that our communications should seek to emphasise this aspect of monetary policy and to reduce volatility arising from month-to-month news. The imprecision of economic forecasts further out in time and the volatility in monthly movements of many economic indicators also needs to be strongly reiterated in communications to the media, financial markets and policy circles.

Additional Duties and External Engagement

Since joining the Monetary Policy Committee, I have undertaken a range of activities to inform decision-making, to support the MPC's communications, and to engage with young people to develop their interests in economics and economic policy. I have sought to interact with people outside of London and beyond financial markets and academic circles in order to communicate and disseminate policy reasoning, and to ensure that we reach all our stakeholders – not just those that have traditionally had access to Bank thinking. I will continue to develop this approach in the future, such as through regional visits and engagements with non-financial media, particularly as my staffing constraints ease.

My activities over the past year include:

- Regional visits (West Midlands, North East, South West, Greater London), including a school talk to A-level students, a community forum, company visits and business roundtables in various parts of the country.
    - The West Midlands visit included a metal manufacturer site meeting in the Black Country and a business roundtable discussion with large and small firms in Birmingham. This provided information on supply chain pressures, recruitment, and future orders and price growth.
    - I visited a credit helpline to hear directly and indirectly on how people were managing financial difficulties and engaged in a community forum in the Black Country, where community groups and charities shared their experiences with the cost of living crisis and the pandemic. This helped to provide insight into the sources of cost of living pressures, which featured in my first speech and its development over various talks.
    - The North East visit focused on infrastructure to get first-hand information on supply chain bottlenecks, including ports and energy. I had in-depth meetings with three companies to understand constraints and lags in supply. I engaged in a roundtable discussion with local businesses in Tees Valley to get insights into their current economic environment and their future operations.
    - The South West visit included activities based on my specialisation, including a trade panel with businesses which covered pricing developments at home and abroad. I visited an inner city Bristol school to explain the various societal questions that economics and economic policy can help address. I also engaged in a Women's panel discussion with female business leaders in the area.
    - The visit to Greater London focused on retailing and high-tech sectors. I visited marketplaces and large retailers to gain insights into food price pressures. I participated in a business roundtable discussion comprising of small and large businesses, particularly in high-tech services where recruitment has been particularly difficult.
    - The regional visits have yielded insights that have featured in my speeches and decisions. Additionally, although not organised as full visits, I have engaged at various occasions with different stakeholders, such as energy companies and local businesses in Manchester and London to understand specific developments in the economy.
- Two on-the-record speeches.
    - The first speech, delivered in March 2023, quantified the contribution of imported inflation to the cost of living crisis, directly and indirectly through

supply chains. Summarised the findings in a VOX.EU blog post, in order to get wider scrutiny of the underlying research.
    - The second speech in June 2023 distilled information on historic and recent trends in producer price inflation, using granular prices. It laid out evidence for clear indications that consumer price pressures were expected to ease. I delivered this speech at Manchester Metropolitan University.
- Training staff. I worked closely with Bank staff on analysis for my two speeches. I taught new methods for analysing the data and evaluating domestic and imported components of inflation.
- Resolution Foundation. Speech and roundtable to promote research and data analysis on the UK's engagement with the world economy.
- Royal Economic Society's Women in Economics Network and JP Morgan. Speech on price statistics to encourage research and discussion among young female economists.
- Workshop on Household Finance and Housing - Panel Discussion on 'Impact of Inflation on Households' (Imperial College/Bank of England).
- Discussions with ESCOE, ONS and IFS on analysis of microdata and administrative data for inflation targeting.
- Meetings and interviews with NIESR, OMFIF, Asian Media Group and Observer.