Carney goes on the road to defend forward guidance

By Paul Waldie
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Nottingham is not the first place many would expect the new Governor of the Bank of England to give his maiden public speech. This industrial city of 300,000, about 200 kilometres north of London, is struggling to come out of the recession, and unemployment remains stuck above the national average.

But for Mark Carney, who is in his second month as Governor, Nottingham seemed the ideal place to reach over the heads of financial investors in London who have questioned some of his latest moves, and into the heartland of Britain's economic base.

For weeks, Mr. Carney has faced growing doubts in London's financial district, known as the City, about his unprecedented plan to link future increases in the bank's benchmark rate to the country's unemployment levels.

Under his "forward guidance" policy announced three weeks ago, the bank promised not to consider raising its rate, currently at 0.5 per cent, until unemployment falls to 7 per cent from the current level of 7.8 per cent. And that, he said, could take three years or longer.

Mr. Carney, former head of the Bank of Canada, has insisted the policy will provide stability and certainty for business people and consumers, but few City types agree.

Citing a host of promising economic indicators, many economists and investors expect unemployment to reach the 7-per-cent mark by 2015, meaning the Bank of England will have to raise interest rates much sooner than expected.

Those expectations could choke off the nascent recovery and thwart whatever certainty Mr. Carney has promised.

On Wednesday, Mr. Carney stuck to his guns. Britain's economic recovery is "solid, not stellar," he told a business audience in Nottingham.

Suggestions that the 7-per-cent level will be hit by 2015 are "built not on hope, but on expectation," Mr. Carney added. By his calculation, he said, there is only a one-in-three chance of unemployment falling that quickly.

Mr. Carney seemed to relish his chance to meet local business people and, at a news conference after his speech, seemed exasperated by the steady second guessing of his plan for the British economy.

"We're in a recovery that is just beginning," he said. "There are signs of some broadening of that, but it's just beginning. It is a long way back, a very long way back. We're lagging virtually everyone else in the advanced world."

Mr. Carney added that focusing on market reaction misses the point. "What I'm hearing … is that there is an appreciation for that greater degree of certainty that's being provided by the bank," he added.

He went on to point out that his message was aimed at the members of the Nottingham audience – people who put capital to work. Once the centre of U.K.'s industrial production, the city is trying to transform its economy with a focus on its university and hospitals.

Mr. Carney also said the central bank is prepared to take unspecified action if market rates begin to creep up.

One measure announced Wednesday was an easing of some liquidity rules for major banks, something Mr. Carney hopes will encourage them to boost lending. He noted that 70 per cent of household loans and 50 per cent of business lending is linked to the bank rate, not the market.

But few seemed convinced, and investors continued to price in an interest rate hike by early 2015 after his speech.

Mr. Carney "underwhelmed some expectations for the opportunity he had today to respond to market defiance of the forward guidance strategy," said Sam Hill, of Royal Bank of Canada's investment arm in London.

However, Mr. Hill added that the message could yet be heard. "Although Carney hasn't affected a correction to a lower path for market expectations of the bank rate today over the medium term, we think the message will sink in, especially if the recent run of strong domestic data fades."