INFLATION REPORT PRESS CONFERENCE

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Opening Remarks by the Governor

In today's *Report*, the recent pattern of revisions to the projections over the next year – downward to growth and upward to inflation – has continued. But looking further ahead, the horizon relevant for policy, the big picture has not changed much since February.

Although inflation fell to 4% in March, it remains uncomfortably high and well above the 2% target. And there is a good chance that, if utility prices rise further later in the year, inflation will reach 5%, before falling back through 2012 and into 2013. Inflation is being pushed up by a range of influences – primarily the past rises in commodity and import prices, as well as the increase in the standard rate of VAT. Inflation can be extremely sensitive to movements in these factors, and, in the past week alone, we have seen how volatile commodity prices can be. So there is a great deal of uncertainty about the outlook for inflation.

An important question for the MPC is whether the current high rate of inflation will affect its medium-term level. There is a risk that continuing high rates of inflation will push up on inflation expectations, or lead to some resistance to the erosion of real take-home pay. Either of these mechanisms could put upward pressure on wages and prices looking ahead, and imply that inflation will not fall back as sharply when the temporary effects of higher VAT, energy and import prices come to an end.

But there are other influences on wages and prices that are currently pushing in the opposite direction. The most obvious is the weak level of activity in the economy. It is now clear that underlying activity growth slowed markedly around the turn of the year. Looking through the volatility associated with heavy snow last December, the level of output appears to have been broadly flat over the past two quarters, and remains about 4% below its peak prior to the crisis. This low level of activity is acting to restrain domestic inflationary pressures: both wage and money growth, at around 2%, continue to be weak. The MPC expects that the recent softness in activity will prove temporary, with a recovery in output likely to be driven by a continuing rise in business investment and a positive contribution from net exports. But there are clear downside risks to this view – household spending may have further to adjust to the significant squeeze in real incomes and there is substantial uncertainty over the speed at which net exports will pick up.

The Committee faces two key issues in judging the prospects for inflation in the medium term. First, will the weakness in activity persist and continue to restrain domestic wages and prices? And second, are there other factors that will push up on wages and prices in the medium term? Chart 3, on page 7 of the *Report*, shows the Committee's best collective judgement of the range of outcomes for CPI inflation. It is based on the assumption that Bank Rate follows a path implied by market interest rates and that the stock of purchased assets financed by the issuance of central bank reserves remains at £200 billion throughout the forecast period. The projection in the first part of the forecast is markedly higher than in February, mainly reflecting the probability that the increases in energy prices between February and May will raise electricity and gas prices. Inflation is likely to fall back through 2012 and into 2013 as the temporary impact of the factors raising inflation wanes and some downward pressure from spare capacity in the economy persists. The extent of that fall is likely to be moderated by some upward pressure on nominal wages, reflecting resistance to the continuing squeeze on real earnings, and some drift up in inflation expectations. Overall, the chances of inflation being above or below the target in the medium term are judged to be about the same.

The accompanying outlook for GDP growth is shown in Chart 1, on page 6 of the *Report*, under the same monetary policy assumptions used for Chart 3. It shows that four-quarter growth is likely to pick up during 2011, although there could be some further volatility in quarterly growth rates. The most likely outcome for growth in the medium term is somewhat weaker than in the February *Report*, reflecting a delayed recovery in consumption and a less pronounced boost from net exports. But the downside risk to that outcome is judged to be smaller than in February, so that from the two-year point of the forecast onwards, the average outcome, taking into account the balance of risks, is broadly unchanged. Overall, the Committee's best collective judgement is that by the second half of the forecast period, the chances of four-quarter growth being either above or below its historical average rate are broadly equal.

Inflation remains volatile, with sharp month-to-month movements. As I have argued before, the MPC needs to look through such short-term fluctuations, and focus on the outlook in the medium term. As the economy gradually recovers from a deep recession, and rebalances towards a more sustainable path, the outlook for growth and inflation is likely to remain unusually uncertain. Perfectly reasonable differences in judgements regarding the size and nature of the forces affecting the economy can have a material impact on the outlook. No one knows how the economy will evolve over the next few years; nor how policy will need to respond. But I can assure you that the Committee is united in its determination to ensure that inflation returns to the 2% target in the medium term.