Mark Carney (MC) interview with Joel Hills (JH) ITV 13th January 2015

JH: Mark Carney, you are writing a letter to explain why inflation undershot the target. What is the explanation? Why is inflation falling?

MC: Well, the principal explanation for why inflation has come down so rapidly has been big falls in food and energy prices, most notably oil. Oil prices are down 60% over the course of the last year, and that’s driving lower prices at the pump, lower prices at the shops, and those have been the principal reasons. We are seeing, as we have seen for some time, relatively modest price pressures more broadly in the economy...

JH: You have previously taken the view that the fall in oil prices was pretty supportive, it was a benign effect. Is that still your view?

MC: Look, short term, this is good news for British households, you know, they can stretch their pound farther. But what we want to avoid, and what our responsibility is to avoid, is to make sure those falls in prices don’t become more generalised. Because a bit of inflation is good for the economy, it greases the wheels of the economy. The good news is that we have the means, and the will and the responsibility given to us by Parliament to get inflation back up in the medium term – within two years, let’s say – to that 2% inflation target, and we will do that.

JH: Okay, manage our expectations – inflation is likely to keep falling, isn’t it?

MC: It is likely to drift a little lower, yes, in subsequent months, and so I have to write a letter to the Chancellor, as you alluded, next month, and then I’ll probably have to write at least one more after that because there have been these big falls in oil prices, energy prices, some of the import prices, and some of that is still in the pipeline.

JH: Will inflation turn negative?

MC: It’s possible, the MPC provides an updated forecast, which will come out in February, and this is one of the questions we’re looking at right now, so I’d rather defer that until that forecast.

JH: Sure, but I mean you have a view. What is your personal view? How likely is it that we’ll see deflation?

MC: Well, let’s make a distinction here. There is a question of whether inflation actually turns negative, but the bigger economic questions – the more relevant question for British households, is whether we sustained and widespread falls in prices across a range of categories. We’re not seeing that. The Bank of England’s job is to make sure we don’t see that, and I said, we have the means to ensure that that doesn’t happen. But let me be absolutely clear Joel, what we are talking about is an economy that is growing solidly, that has created more than half a million jobs in the course of the last year, and wages are starting to increase, so the question for monetary is the pace of interest rate increases – so you can expect, and your viewers can expect, that over the course of the next few years, interest rates are going to increase at a limited and gradual pace, and maybe a little more limited and little more gradual than we would have thought a year ago given the major developments abroad.

JH: Let’s get on to that in a minute. Why is deflation something you are keen to avoid?
MC: Well, it (inflation) greases the wheels of the economy, so what does that actually mean. It makes it easier for businesses to change wages, and that helps with hiring. It makes it easier for people to repay the debts that they have taken out. They have taken those debts out with expectations of certain changes in price levels and interest rates. And quite frankly it goes back to monetary policy; it makes it much less likely that central banks will have to resort to extraordinary measures. Now we have had to resort to extraordinary measures, but we are in a position now where the conversation at the Bank of England is about the pace of conventional measures, the pace of interest rate increases.

JH: Sure, but you were suggesting that you wanted to see deflation as something you want to avoid. Why?

MC: Because as I just said, if you have a bit of inflation, the target given to us by Parliament – 2% CPI inflation, having a bit of that makes it easier to changes wages for individuals, and that means you can hire...

JH: So what happens when you get a lot of that?

MC: Well you don’t want a lot of it. The sweet spot is you want low, stable, predictable inflation.

JH: And what if we don’t get that?

MC: Well, you’re going to get that because that’s the responsibility of the Bank of England and...

JH: How can you guarantee that?

MC: Monetary policy operates over the medium term; think a year and a half, two years out. It takes a while for the changes in policy...

JH: Okay, but you can’t control oil prices, you cannot the price of food or the price of petrol, there is nothing you can about that?

MC: Joel, there is a very simple point here which is that, the price of oil falls sixty percent, what happens then? That price moves to the price of petrol, and we start to see it at the pump. Unleaded was 1.17 in December, it is 1.09 this morning. Inflation is a rate of change in prices, so once it falls, the question is what happens then? A big sharp fall in oil prices, a one-time big change in oil prices doesn’t lead to consistent lower oil prices or lower inflation...

JH: if it’s temporary, but sorry my point is...

MC: it can’t go below zero Joel

JH: Okay, but my point is that you make it sound as if it is something you have control over.

MC: We have control; we have tremendous influence on prices in this economy – broad-based prices – through the price of money. We change interest rates, we change the effectiveness of the banking system, something we can do, and we’ve been making the banking system much more effective, getting credit out to British people, mortgages rates for example, mortgage rates are at record lows. So when you change those interest rates, it changes the incentives of people to borrow, to spend, businesses to invest, businesses to hire. That changes the dynamics and we have been providing
stimulus to this economy, it’s why this economy is growing faster than trend. It is why businesses are hiring, it’s wages have started to turn, and it’s why inflation, broad levels of prices in this economy – when you buy a service, when you buy a good, those broad prices are starting to move up, and we will chart a path for monetary policy so those prices continue to move to two percent. This is the most important point.

**JH:** You’ve made that point. We are in the sweet spot, as you have put it, but I just want to be absolutely clear on this Mark Carney, how likely is it that we will see deflation – likely, not very likely?

**MC:** The level of inflation, the rate of inflation is likely to go lower.

**JH:** Will we get deflation?

**MC:** It’s possible that prices will fall in a given month on a year on year basis. Absolutely, that’s possible. But broad-based price falls across a broad range of goods and services, a change in peoples’ expectations? No. Because, the Bank of England has the means, we have the will, and we have the responsibility, and we will our responsibility to provide that necessary stimulus. Again, to be absolutely clear, the path of policy in order to achieve our target is likely to be one of gradual and limited interest rate increases?

**JH:** Okay does inflation this low mean that interest rate rises are a long time off now?

**MC:** I just said. Listen to what I said. You can expect over the course of the next couple of years, gradual and limited interest rate increases.

**JH:** Okay, the market is betting on rate hike next summer. Does that sound sensible?

**MC:** I’m not going to put a precise timeline on it.

**JH:** Well last June you said rises could be sooner than expected, do you think they are going to be later than expected?

**MC:** It’s called the conditional Joel, which is that I said they could be sooner than market currently expects.

**JH:** Okay, could they be later than the market currently expects?

**MC:** It could be sooner, it could be later.

**JH:** Mark Carney, thank you very much.

**MC:** Thank you.

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