

INFLATION REPORT PRESS CONFERENCE
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Opening Remarks by the Governor

A synchronised economic recovery around the world seems well under way. At home, signs of current and prospective strengthening of demand have led the Monetary Policy Committee to raise its projection for output growth in the near term. Inflation is likely to rise gradually, despite the lower than expected outturn in March. So, at its meeting last week, the MPC judged that, without further increases in interest rates, it was more likely than not that inflation would exceed the 2% target in the medium term.

Inflation was 1.1% in March, partly reflecting temporary factors. In the near term, utility and petrol price increases are expected to exert upward pressure on inflation. Oil prices have risen sharply over the past month, reflecting world recovery, higher desired levels of inventories, and political uncertainties, and represent a key risk to the near-term outlook. In the medium term the anticipated pickup of inflation is the consequence of growing pressure of demand on supply capacity.

The main news on demand over the past quarter has been the unexpectedly high rate of house price inflation - the annual rate is now around 20% on the two main lenders' indices - which has helped to prolong the period of above trend consumption growth. It should go without saying that the Committee does not target house price inflation. But house prices, as they always have, do influence our judgement on the outlook for consumer spending and hence CPI inflation, which *is* our target. The implications of the recent buoyancy in the housing market for consumption depend critically on three factors. First, the extent to which house prices, relative to earnings, are above a level which can be sustained in the long run. Second, the nature of any adjustment to a sustainable level. Third, the impact of changes in house prices on consumption. There is enormous uncertainty about all three factors. In the Committee's central projection, house price inflation slows sharply during the next two years, although house prices may well continue to rise strongly in the near term. That is likely to mean that consumer spending continues to grow strongly for a while, but then to ease as the growth in disposable incomes and house prices moderates.

In recent quarters the labour market has been remarkably stable, with few signs of upward pressure on labour costs. But it now appears to be tightening gradually. Employment picked up significantly in the three months to March, as shown in this morning's figures, and unemployment fell to its lowest level for almost 30 years. Earnings growth and wage settlements have started to edge up, and regular pay growth, adjusted for hours worked, may now be around 4 ½% a year.

The Committee's latest projection for GDP growth, on the assumption that official interest rates remain constant at 4.25% throughout the two-year forecast period, is shown in Chart 1 on page iii of the Report. The central projection is for growth to be above its historical average in the near term, and then to slow as both consumer and public spending moderate.

The Committee's projection for CPI inflation, again conditional on official interest rates of 4.25%, is shown in Chart 2, also on page iii. The central projection rises steadily, and moves above the 2% target towards the end of the two-year forecast period. That is a little higher than in the February *Report*, but in the earlier part of the forecast period the central projection is a little lower. Chart 3, on page iv, shows the corresponding projection on the assumption that official interest rates move in line with market expectations. The increases in interest rates embodied in the market yield curve lead to somewhat weaker growth and a more modest rise in inflation, although the central projection at the two-year horizon remains a little above target.

At its meeting last week, therefore, the MPC judged that an increase of 0.25 percentage points in the official interest rate was necessary to keep inflation on track to meet the target in the medium-term. But how monetary policy will unfold over the next few months I do not know. Nor, I suggest, can anyone else. That will depend upon the resolution of the many uncertainties currently facing us.