INFLATION REPORT PRESS CONFERENCE

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Opening Remarks by the Governor

For the past year GDP has grown at a rate around its long-term average. Inflation has picked up and has been above the 2% target since May. Overall, the central view described in this *Inflation Report* is one of inflation rising further above the target in the near term, before falling back to the target over the forecast period. The risks around that benign central view are seen by the Committee as broadly balanced, but, as in August, there is significant uncertainty about the outlook for inflation.

Output growth is presently estimated to have been constant in each of the past four quarters. Consumer spending has been volatile but, taking the past year as whole, has risen broadly in line with output. Business investment has been stronger than the MPC anticipated and surveys of investment intentions have generally picked up. The world economy has continued to grow rapidly and, consistent with that, surveys of export prospects are strong.

The outlook remains one of a continued modest rebalancing of demand, with consumer spending growing at close to its long-run average rate over the forecast period, business investment continuing to recover, and net trade making a small positive contribution to growth.

The Monetary Policy Committee's projection for GDP growth is shown in Chart 1 (GREEN CHART) on page 7 of today's *Report.* That projection is based on the assumption that official interest rates move in line with market expectations over the forecast period. The central projection is for GDP to continue to grow at around its average rate over the past decade. Overall, the projection is marginally stronger than in the August *Report*.

In the Committee's view, the risks to output growth around the central projection are broadly balanced. In the short term, there are upside risks from the momentum of recent demand growth supported by continuing rapid growth of broad money, credit and asset prices. But there are downside risks from a more widespread slowdown in the world economy.

The Committee judges that there is particular uncertainty about the supply side. As a result, assessing the margin of spare resources in the economy is unusually difficult at present. Capacity utilisation within companies, as measured by surveys, has risen since August. In contrast, unemployment has risen further. But it is difficult to know how much of the rise in unemployment actually represents increased slack in the labour market.

Over the past year or so, the labour force has grown rapidly, following strong migration from Eastern Europe and elsewhere, and a rise in participation rates. There is, of course, great uncertainty about the scale of migration which has clouded estimates of the supply capacity of the economy. Moreover, it is difficult to know how far migration affects demand for goods and services as well as supply. The overall impact of migration on inflation in the medium term is unclear.

Some of the pickup in unemployment over the past year or so probably reflects the impact of higher energy prices and some deterioration in the terms of trade. In response to recent rises in energy costs, companies have raised output prices and pay growth has been subdued. Nevertheless, profit margins have been squeezed. The fall in oil prices since August will relieve some, but not all, of the pressure on profit margins. In the Committee's central projection, pay growth continues to be modest, but profit margins are rebuilt, resulting in some countervailing upward pressure on consumer prices.

The Committee's projection for CPI inflation is shown in Chart 2 (RED CHART) on page 8 of the *Report*, again on the assumption that official interest rates follow market expectations over the forecast period. In the central projection, inflation picks up further above the target in the near term reflecting, in part, movements in petrol prices, higher university tuition fees and pre-announced rises in utility prices. But further ahead, the central projection is for inflation to fall back to the target as energy and import price inflation moderate, although the impact of this is partially offset, first, by the rebuilding of profit margins and, later, by a modest recovery in pay growth.

As always, the probability of the central projection materialising is low. The risks to the outlook for inflation appear broadly balanced although they are large in both directions. Inflation is likely to remain volatile over the coming months, but the main risks to the inflation outlook in the medium term surround the behaviour of pay growth and any recovery of profit margins as energy price inflation falls.

Against a background of firm growth and a limited margin of spare capacity, and with inflation above the target, the Committee judged last week that an increase of 0.25 percentage points in Bank Rate was necessary to keep CPI inflation on track to meet the target in the medium term. The Committee remains ready to take whatever action might be necessary in future. And it will continue, as always, to take its decisions one month at a time.