



BANK OF ENGLAND

News release

Press Office

Threadneedle Street

London EC2R 8AH

T 020 7601 4411

F 020 7601 5460

press@bankofengland.co.uk

www.bankofengland.co.uk

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The MPC and the UK Economy: Should we fear the D-words? - Speech by Charles Bean

In a speech to the Emmanuel Society today in London, Charles Bean, Chief Economist and Executive Director of the Bank of England, looks at two key aspects of the risks to the current economic conjuncture: those associated with deflation and debt.

He argues that some of the more alarmist commentary about the threat of global deflation is overdone. Although Japan is already experiencing falling prices with zero interest rates, it is still a long way from falling into the sort of deflationary spiral that characterised the United States during the Great Depression. And while a sharp contraction in consumer spending would pose a threat to the US recovery, there are good reasons for believing that the US economy is unlikely to follow Japan into deflation. He views low inflation in Germany as, to a large extent, part of a process of regional relative price adjustment in the context of monetary union, rather than as the beginnings of a classic deflationary process.

Mr Bean notes that a similar argument applies in respect of the low rate of goods price inflation in the United Kingdom - again it represents part of a process of relative price adjustment rather than general price deflation.

While he sees these points as reasons to discount some of the more extreme commentaries on deflation risks, it is important that monetary policymakers are alive to the possibility of deflation however remote that may be, and stand ready to act pre-emptively if warranted.

The build up of consumer debt does, however, present the MPC with perhaps a more immediate threat. The MPC's central expectation is that growth in consumer spending will ease back over the next year or two and the rate of increase in house prices will slow markedly. But it is possible that house price inflation and consumer spending may continue to be stronger than expected in the near term, which raises the possibility of sharper adjustment in the future. So there are upside risks in the near term, but downside risks further out. Consequently, starting from a position with inflation below target, there may be something of a trade-off between getting inflation back to target in the near-term and staying close to it further out.

Key Resources

The MPC and the UK Economy: Should we fear the D-words? - Full Speech

<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2002/speech182.pdf>