



**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

24 May 2005

## **Monetary Policy-Making: Fact and Fiction – Speech by Richard Lambert**

In a speech today in Bristol, Richard Lambert, an external member of the Monetary Policy Committee, reflects on his two years on the MPC and on the uncertainty inherent in setting monetary policy.

Mr Lambert says that when setting interest rates, “it is critically important to recognise the lack of certainty about all the key issues which have to be addressed”. Although there are yardsticks – such as the output gap and neutral interest rate – against which to judge the appropriate course of action, few of them are directly measurable or easily observable. Yardsticks may also be based on assumptions that are simply wrong and on data that are subject to revision. Mr Lambert says “...there are no set rules”. He demonstrates the difficulties by considering the uncertainty surrounding the neutral real interest rate, measures of the output gap and the equilibrium unemployment rate. He argues that “...it is impossible at any moment in time to pin down the neutral rate with the degree of precision necessary to use it as a guide in each month’s decision”.

Mr Lambert argues that, given the uncertainties, it is important for monetary policy-makers to consider as wide a range of information inputs as possible, though he notes that some are worth more than others. The priority is to “concentrate on the big picture and on the issues which would lead to trouble if the Committee got them badly wrong”.

He emphasises that forecasts of economic growth and inflation are not translated into policy in a mechanical way and Committee members have to be ready to exercise their judgment. The structure of the Committee helps, since there is enough continuity on the MPC to provide a collective memory of how problems were tackled on similar occasions in the past, and enough fresh thinking to bring new ideas to bear.

Looking ahead, Mr Lambert says that “...the central projections in our latest Inflation Report, for May look remarkably benign: the economy growing around trend, inflation pretty well bang on target for most of the next three years, market expectations of interest rates moving sideways at around their current level for years to come... But that may turn out to be too rosy a view”. He notes the question marks over consumption, and the outlook for the euro area. He goes on to say that, “At the same time, there are a few

signs that inflationary pressure may be building a little around the world, and not just as a result of higher oil prices”.

So he believes that his “third year on the Committee may turn out to be even more interesting and challenging than the first two”.

### **Key Resources**

Monetary Policy-Making: Fact and Fiction

Speech by Richard Lambert, Member of the Monetary Policy Committee at a South West Agency Dinner in Bristol on 24 May 2005

<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2005/speech247.pdf>