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News release

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Monetary Policy Challenges Facing a New MPC Member - Speech by David Walton

Speaking to a business audience at a lunch organised by the Bank of England's Agency for the South West in Exeter, David Walton, the newest member of the Monetary Policy Committee said it has been a very interesting, and challenging, time to join the MPC. Mr Walton voted for a cut in interest rates at his first two meetings of the MPC in July and August.

Mr Walton gives three reasons why he believes the MPC was right to cut interest rates from 4¾ per cent to 4½ per cent in August.

"First, there is a downside risk to the Committee's central projection for growth which, in turn, creates a downside risk for inflation further out. Household spending growth, in particular, has been very weak during the first half of this year … a further period of subdued consumption growth seems quite likely… Business investment prospects are also very uncertain."

"Second, the rise in inflation over the past year needs to be kept in perspective. Despite the severity of the oil shock, inflation is only a little above its symmetric target of 2 per cent after a prolonged period in which inflation has been below target… The slowdown in growth over the past year should lead to some moderation in inflationary pressure further ahead. The stability of wage inflation and the decline in cost and price pressures across a range of business surveys in recent months suggest that, for the moment at least, any second round effects from higher oil prices will be modest."

"Third, if it were not for the asset price movements observed between May and August, the Committee would have been faced with the prospect of an undershoot in the inflation target two years ahead… To keep inflation on target, I judged it necessary to validate at least part of the market expectation for lower interest rates."

For Mr Walton, "oil is a big uncertainty for the outlook for both growth and inflation. Increasingly, the shock from oil prices seems larger and more permanent than expected. Oil prices have doubled since the beginning of 2004; the oil futures market suggests that much of this increase in prices may persist. High oil prices act like a tax, transferring money from consumers to oil producers, leaving many of us worse off."

On the consequences of high oil prices for monetary policy, Mr Walton concludes that “the appropriate monetary policy response depends on how households and businesses react. There is a wide range of possible outcomes. Demand could conceivably soften too much if business and consumer confidence are damaged. Inflation expectations could become destabilised if inflation moves too far away from target. And some productive capacity could be lost permanently. When thinking about my recommendation for interest rates in coming months, I will be considering carefully how each of these will affect the chances of meeting the inflation target.”

Key Resources

Monetary Policy Challenges Facing a New MPC Member
Speech by David Walton, Member of the Monetary Policy Committee, at a lunch with the Exeter business community, in Exeter on 16 September 2005
http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2005/speech254.pdf