



BANK OF ENGLAND

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Perspectives on Current Monetary Policy

Speaking to the Cardiff Business Club tonight, Rachel Lomax, Deputy Governor for Monetary Policy, looks at the longer-term international context for UK monetary policy, and links this to the challenges now facing the MPC.

Noting that the UK has not been alone in enjoying a decade of unusual stability, she observes that economists have debated whether the 'Great Stability', as it has been called, is the result of good luck or good policy. She argues that there has been a virtuous circle over the past 10 to 15 years, in which central banks have taken advantage of relatively favourable global conditions to implement successfully better policy-making frameworks and establish strong reputations for competence. But this increase in stability was not foreseen when the MPC was set up. Its formal remit makes allowance for situations in which inflation might be thrown sharply off course, and where attempts to keep it close to the target might cause undesirable volatility in output.

Turning to the present situation, she says that she does not read the fact that inflation is currently above target as convincing evidence that the economy is overheating. Rather, the headline rate of inflation is still being pushed around by movements in energy prices and other one-off effects, and unemployment has been rising for most of the last 18 months. While demand has not been growing unusually slowly over the past year, it is now two and a half years since it grew at a rate significantly above its long-term average. And that average could be an underestimate of how fast we could safely grow, given the recent rapid growth in the labour force.

She recognises the risk that a high headline rate of inflation could generate inflationary wage demands, but observes that there is quite a difference in today's labour market between asking for higher pay and getting it. In conclusion she says ..."insurance is never costless. Taking out insurance against risks that don't materialise can inject unnecessary volatility into the economy, with consequences for jobs as well as demand. That is why we have the remit we have."

<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2006/speech292.pdf>