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The MPC Comes of Age - Speech by Rachel Lomax

Speaking at De Montfort University tonight, Rachel Lomax, Deputy Governor for Monetary Policy, considers what has been special about the Monetary Policy Committee as it approaches its tenth birthday; and asks how age and success has changed it.

The key characteristic of the current approach to monetary policy is encapsulated in the term 'constrained discretion', which she says is defined by Ben Bernanke as "an approach that allows monetary policy-makers considerable leeway in responding to economic shocks, financial disturbances, and other unforeseen developments. Importantly, however, this discretion of policy-makers is constrained by a strong commitment to keeping inflation low and stable."

The so-called Great Stability of the past decade has bestowed on the MPC "the great gift of credibility." But the Great Stability is itself something of a puzzle and its legacy has helpful and unhelpful aspects. Referring to the policy challenges posed by the impact of higher energy prices, she comments: "On the helpful side, there is no doubt that a highly credible monetary policy framework has helped to contain inflation, in the face of a very large cost shock. The less helpful legacy is that even a small movement in inflation away from target - one percentage point - has prompted some highly coloured media coverage, and may have unsettled people's expectations about where inflation is headed in the short run."

She says "there is a dilemma here, with which the MPC has been grappling over the past few months. And it has left me with a nagging worry. My concern is this. If the price of maintaining the public's confidence is that we have to try to keep inflation within a whisker of the target at all times - even in the face very large shocks - the flexibility that is such an important feature of our present arrangements may get significantly eroded. That is why it is a pity that the open letter procedure has been widely misrepresented as a punishment rather than as an opportunity for the MPC to explain itself".

Noting that the Committee's own procedures and communications have not changed greatly in the past decade, she argues that the Committee has acquired a track record which outside commentators have come to parse with great precision, so that "any deviation from past behaviour is assumed to be considered and deliberate". While today's committee members quite reasonably do not want to be unduly constrained by the

habits of their predecessors, "changing established patterns of behaviour requires at least as much care and explanation as in the early days of the framework".

She observes that other inflation targeting central banks have moved increasingly towards giving indications about the likely path of interest rates, given their forecast for the economy. The MPC has "maintained the position that we do not give hints about future interest rate changes. Naturally we are looking closely at what happens elsewhere and we will want to learn from their experience - though of course, since the MPC is not a consensual body, it would be a significant complication to get it to agree an explicit path for interest rates".

<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2007/speech303.pdf>