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All Along The Watchtower - Speech by Spencer Dale

This morning, Spencer Dale - Chief Economist and member of the Monetary Policy Committee - talks about the challenges currently facing the UK economy. He focuses in particular on the risks posed to consumer spending from deteriorating housing market conditions and from the possibility that the current period of elevated inflation may lead to an increase in generalised wage and price pressures.

He notes that the UK economy is grappling with "the combined challenge of an exceptional surge in food and energy prices and a period of intense strain within financial and credit markets." Adding that "the adjustment to higher commodity prices and to a more sustainable financial system will be painful, characterised by a period of broadly flat output and high inflation."

On falling house prices, he argues that declining house prices have to be put in the context of recent increases, and "the main focus of the Monetary Policy Committee has to be on the implications for the wider economy, not on the housing market itself." "For society as a whole, a change in house prices in itself does not significantly affect our well being." However, he notes that "the deterioration in the housing market may amplify the impact of tighter credit conditions on consumer spending."

Turning to inflation expectations, he considers how the period of temporarily high inflation affects households' and businesses' expectations about future rates of inflation. "By their very nature, the inflation expectations of households and firms are difficult to assess and their relationship with wages and prices is imprecise." "I remain alert to the possibility that the current period of high inflation may cause inflation expectations to become less firmly anchored."

In conclusion, he states that the Monetary Policy Committee will continue to take into account both the downside risks to consumer spending from the housing market and the upside risks to wages and prices from elevated inflation when assessing the appropriate stance of policy. In his view "these risks are finely balanced but as the economic environment changes, so too can the balance of risks."

<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2008/speech357.pdf>