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BANK OF ENGLAND

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Money and Credit, Twelve Months On Speech by Paul Tucker

In remarks at the Money, Macro and Finance Research Group 40th Annual Conference in London, Paul Tucker - Executive Director, Markets and member of the Monetary Policy Committee - reiterated the MPC's commitment to low inflation in the medium-term, and the need for inflation expectations to be anchored. He says, "Success in anchoring inflation expectations in line with the target will give us more scope over time to cushion the economy from the adverse shocks to growth - which of course we would want to do when we can, consistent with medium-term stability".

Discussing the inflation outlook, he says, "It is a convenient but in some ways misleading shorthand to characterise the Committee as currently balancing a growth risk against an inflation risk. Given our mandate. that is better thought of as our having to balance the downside risks to inflation over the medium-term against the upside risks to inflation over the medium-term. In stressing why controlling inflation matters to growth, he adds, "There is not a comfortable medium-term trade off between growth and inflation. Inflation is just the opposite of a free lunch. If in the interests of sustaining growth in the short run, we were to let inflation become established at higher levels, things could easily get out of control as higher medium-term inflation expectations would become embedded. We would then find it much harder to bring inflation back to target, and could well end up having to generate a serious recession to put the genie back in the bottle. The experience of the thirty years before the current regime demonstrated the economic and social costs - to households, livelihoods and businesses - of what that entails."

Commenting on developments since publication of the latest Inflation Report in August, he says: "On balance, those developments mostly comprise downside news. to the outlook for demand and for inflation. But the recent depreciation of the exchange rate has to be offset against that. And headline inflation ticked up to 4.4%. It will probably rise further. The Committee can and will ensure that this is a temporary state of affairs. But, for the moment, inflation expectations do continue to flash an amber light. Meanwhile, credit has remained tight, and underlying money growth has decelerated, implying that monetary conditions may be leaning against those incipient inflationary pressures".

In the context of current financial and macroeconomic conditions, Paul Tucker discusses areas of research that might be pursued by monetary economists to help policy makers better understand the interactions between finance and the macroeconomy. He says, ".truly incorporating risk into our thinking has to be one of the last great frontiers for applied macroeconomics. For central banks, that would help meet the challenge of integrating our monetary policy and financial stability missions, which cannot be separated in a monetary economy".

In summarising, Paul Tucker notes that policymakers must tackle the task at hand with the tools they have. He says, "There are substantial risks to inflation in both directions over the medium-term. But at present, the most likely prospect remains that, as the global economy slows, accumulating slack in the economy will head off the upside risks to inflation. That strategy relies not only on real-economy interactions, but crucially on the credibility of the target and the Committee. Above all else therefore, we must be clear about our mandate: to deliver stable inflation, at 2%, over the medium-term."

http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2008/speech346.pdf