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Bank of England Quarterly Bulletin - Q3 2008

The Q3 2008 edition of the Bank of England *Quarterly Bulletin* is published today. It contains the following articles and reports:

- *Foreword* by Spencer Dale, Chief Economist and Executive Director - Monetary Analysis and Statistics.
- *Markets and operations*. This regular quarterly commentary discusses recent developments in global capital markets and reviews the Bank's official operations over the period.
- *Market expectations of future Bank Rate*. Market expectations are important to the Monetary Policy Committee (MPC) because they affect the lending and borrowing rates facing firms and consumers. The task of inferring market expectations is complicated by the existence of credit and liquidity risk premia, as well as term premia. This article provides an overview of the available financial market instruments that can be used to infer Bank Rate expectations. It suggests that credit and liquidity premia can be largely accounted for and also explores one potential approach to controlling for term premia. It concludes that, given the uncertainties involved, a variety of methods and information should continue to be used.
- *Globalisation, import prices and inflation: how reliable are the 'tailwinds'*. Not so long ago the focus of much of the commentary on globalisation was on how the increasing integration of emerging-market economies in international trade was likely to provide a favourable 'tailwind' for economies such as the United Kingdom, allowing it to operate for a period of time at a higher level of activity without an increase in the overall inflation rate. But, as is now apparent, some of the consequences of globalisation, such as an increase in the demand for raw materials, may have contributed to the emergence of strong 'headwinds'. This article reviews the impact of globalisation on the United Kingdom's terms of trade. It concludes that policy makers are likely to have to respond not so much to persistent tailwinds, but rather to occasional gusts, coming from either direction.

- *How has globalisation affected inflation dynamics in the United Kingdom?* Globalisation has the potential to affect both how costs respond to changes in domestic economic activity and how inflation responds to changes in firms' costs. This article presents evidence that import prices may now play a larger role in explaining changes in production costs. This underlines the importance of understanding how import prices are determined. But once the more prominent role of import prices is taken into account, the article finds that the response of inflation to movements in firms' costs does not appear to have changed significantly over recent years.
- *The economics of global output gap measures.* Some research has suggested that global influences on UK inflation can be captured by looking at a measure of the global output gap. This article points to a number of conceptual problems and measurement issues. In particular, the appropriate measure may depend on whether developments in the world economy affect domestic inflation via their impact on import prices or via the wage bargaining power of domestic workers.

Note to Editors

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