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The Economic Outlook for 2011 and Beyond - Speech by Charles Bean

In a speech in London, Charles Bean - Deputy Governor for Monetary Policy and member of the Monetary Policy Committee (MPC) - takes stock of the current economic situation, and discusses where the economy might be headed and the challenges that lie ahead.

Charles Bean begins by describing the current conditions, noting that many recent indicators have given comforting signs that a recovery is underway. But "...it may be some while yet before normality is restored.", he concludes.

In discussing the prospects for economic activity in the future, Charles Bean says that an open question is how far the impact of the prospective fiscal consolidation ".has already been taken on board by households.and how much adjustment is yet to come." that might dampen consumer spending looking ahead. He cites evidence from the recent Bank of England/NMG Consulting Survey, which indicates that the majority of households expect to be affected in some way by the fiscal tightening, but less than half have so far actively responded. Regarding business spending, he says that, while financial conditions are more supportive than in the recent past, ".investment spending is likely to be restrained".

Charles Bean notes that a rebalancing in the mix of demand in the economy away from domestic demand and towards net exports is required. The past depreciation of sterling should facilitate such a rebalancing, he suggests, adding that ".it seems reasonable to expect the impact.to continue to build". But there are risks to that rebalancing, in particular stemming from the sovereign debt problems within the euro area. Despite a reasonably robust economic performance in 'core' countries like Germany, some other euro-area countries ".need to restore their competitiveness without the option of devaluation. Instead, in the absence of effective structural reform, they face the prospect of sustained low growth in order to drive down wages and prices", making ".the task of stabilising public debt harder", he says.

The speech concludes by discussing recent developments in UK inflation and the MPC's policy dilemma. Despite an economic recovery broadly in line with the MPC's expectations, inflation has been considerably higher than the MPC expected last summer. The strength of commodity prices related to the buoyancy of demand in emerging economies; a greater-than-anticipated impact on import prices from sterling's

depreciation; and more moderate downward pressure on prices from the margin of spare capacity than expected, have all contributed to the unexpectedly high level of inflation, he argues.

The MPC expects inflation to fall back towards the target as the impact of those temporary factors, as well as of the scheduled increase in VAT in January 2011, dissipates. But he suggests there are clear upside risks to inflation that counterbalance the downside risks arising from the possibility of weaker than expected domestic and external demand. First, Charles Bean says, strong global growth may continue ".to generate upward pressure on the prices of commodities and tradable goods more generally". And, second, there is a risk that "...the period of elevated inflation causes medium-term inflation expectations to drift up, leading to higher rates of increase of both wages and prices". He adds that the MPC will be watching indicators of inflationary pressure ".like proverbial hawks."

Key Resources

The Economic Outlook for 2011 and Beyond - Full speech

<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2010/speech466.pdf>