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Why is CPI Inflation So High? - Speech by Paul Fisher

On a recent visit to Liverpool, Paul Fisher – Executive Director Markets and member of the Monetary Policy Committee – spoke about the factors that had combined to push inflation above the Bank's target and set out what in his view was the appropriate monetary policy response.

Paul Fisher begins by noting that "...it was the stability of price inflation between 1993 and 2007 that was unusual, not the recent volatility which has been quite mild compared with the pre-nineties experience". He says that the most recent spike in inflation has been particularly surprising given that it happened against the background of a deep recession: "One might have expected a recession of this depth to exert considerable downwards pressure on inflation – such that the current CPI inflation rate could easily have been negative." So why is CPI inflation so high? Paul Fisher says it reflects two sets of factors.

First, he says the downwards pressure on inflation from the recession does not appear to have been as strong as it might have been. But whatever the reasons behind that, he adds, it was reasonable to assume that pricing behaviour should be symmetric during the recovery. "If so, then it is unlikely that substantial inflationary pressure would be generated as the result of a recovery in demand: there will be plenty of capacity within firms and a ready supply of labour, both of which should help to keep costs subdued."

Second, Paul Fisher notes that there have been a series of shocks to relative prices that have put temporary upwards pressure on CPI inflation, including changes to the VAT rate, oil prices and the sterling exchange rate. The effects of the depreciation of the exchange rate are the most difficult to identify, depending crucially on why the exchange rate has moved. But his view is that, although there are risks in both directions, "Given the expected degree of spare capacity in the economy over the next few years, and that the temporary factors should wear off, the most likely outcome is that inflation falls back to below target over the next couple of years as shown in the May Inflation Report. On that basis it was sensible not to try and offset the recent rise in inflation by tightening policy."

Key Resources

Why is CPI Inflation So High? – Full speech

<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2010/speech438.pdf>