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News release

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Current issues in monetary policy - speech by Paul Fisher

In a speech delivered today, MPC member Paul Fisher discusses some of the challenges associated with setting monetary policy over the past three years. Speaking at The Global Borrowers & Investors Forum in London, he says that it is necessary "…to look at the source of the shocks to understand their inflationary consequences and judge the appropriate policy prescriptions". He argues that the persistently elevated rates of CPI inflation over the past two years have reflected three real relative price shocks – the rise in VAT, increases in global commodity prices, and fall in sterling since mid-2007. Paul Fisher believes that there is no simple solution to dealing with these real shocks, noting that changing the MPC's remit or amending the inflation target would not magic away the problem. "The unfortunate and difficult truth is that the shocks that have hit the economy recently have not been caused by monetary conditions. They are real economy shocks which make us individually and collectively worse off – we have to pay more tax, we have to pay more, in real terms, for petrol, gas, electricity and imported goods or services."

Paul Fisher discusses how the best policy prescription for these relative price shocks is to allow the one-off price level effects to feed through into higher prices, but to make sure that there are no second-round effects so that inflation subsequently returns to target. He notes how: "The MPC are trying to set the best path back to the inflation target, but even the best path is an extremely uncomfortable one." And that responding by tightening policy would have "…only injected extra volatility to inflation". Importantly, the real adjustment in wages would have been unavoidable even with the benefit of perfect foresight.

He then moves on to discuss the role of modelling and forecasting in policy making. Paul Fisher explains that because economic models can only ever provide a rough approximation of reality, practical policy making comes down to a problem of decision making under uncertainty. He argues that "…the one, indeed the only, thing we know for certain about any forecast of the economy is that it will be precisely wrong. That is also why the MPC puts little weight on its central projection, and chooses to communicate its judgments to the public by focusing on the range of possible outcomes and the balance of risks, as summarised in the fan chart." He notes that the important question "…is not whether we got the central projection right but whether we set the right policy, given what we knew at the time". He concludes: "I do not think I have heard many argue that we should have done something materially different with policy during the depths of the recession in 2009 in order to generate a different outcome for inflation now."

Key Resources

Current issues in monetary policy – Full speech