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Speech

Setting UK Monetary Policy in a Global Context

Speech given by

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I am delighted to have the opportunity to speak to this distinguished audience here at the Guildhall this evening, and I am grateful to the European Policy Forum for organising this event and to the Corporation of the City of London for hosting it. Developments in the financial sector and in financial markets have dominated UK monetary policy during the time I have spent as a member of the Monetary Policy Committee (MPC). And with my term on the Committee coming to an end in the middle of this year, I am starting to look back and reflect on some of these developments, as well as drawing lessons for current policy and for the future.

My time on the MPC has coincided with an exceptional and unusual period for economic policy-making, in the UK and worldwide. Maybe I should have seen this coming when I joined the Committee. My previous experience with national economic policy-making, as the CBI's Economics Director and a member of the Treasury Panel of "Wise Men", was in the turbulent times of the late 1980s and the early 1990s. My time at the CBI from 1986 to 1993 encompassed the "Lawson Boom", the early 1990s recession, the UK's departure from the ERM in September 1992 and a number of other momentous global events – the end of the Cold War, the collapse of communism across Eastern Europe and the former Soviet Union, the reunification of Germany and the first Iraq war.

Notwithstanding these portents from the past, there was little indication of the turbulence to come when I joined the MPC in the autumn of 2006. For more than a decade, the UK economy had experienced a long period of sustained and steady growth accompanied by low inflation, and this pattern persisted for my first year or so on the Committee. From the early 1990s until 2007, the UK's GDP growth rate averaged close to 3% and fluctuated from around 2% to 4%.¹ Over this period, inflation also remained within or close to the target parameters set by the government.² It was not until the spring of 2007 that inflation deviated more than one percentage point from the target level set for the MPC under the current monetary policy framework, and the Governor of the Bank of England had to write the first of his open letters to the Chancellor on behalf of the MPC.

All that changed, however, in 2008 and 2009, as the UK economy felt the impact of the global financial crisis and other effects of a turbulent world economy. This global turbulence led to a deep recession for the British economy and in most other major economies. At the same time, UK inflation has been much higher than expected and much more volatile than in the inflation-targeting period from 1993 to 2007. CPI inflation reached over 5% in the autumn of 2008, dropping to just over 1% a year later but quickly bouncing back to over 3%. Whereas the Governor wrote only one open letter to the Chancellor (in April 2007) in the first decade of the MPC, he has written a further eight letters in the past three years. This run of letter-writing

¹ Over the period of expansion from 1991Q3 to 2008Q1, GDP growth averaged 2.8%. The annual GDP growth rates over this period fluctuated between 2.1% (2002) and 4.3% (1994)

² Prior to the establishment of the MPC in 1997, the Inflation Target was a 1-4% range for RPIX inflation which was not breached. Under the MPC, the annual rate of RPIX inflation did not move more than 1 percentage point away from the 2.5% target in the period 1997-2003. The annual rate of CPI inflation, the target measure from 2004 onwards, did not move more than 1 percentage point way from its 2% target until March 2007.

appears set to continue throughout this year, with inflation soon expected to rise to around 4% and possibly go even higher.

This experience has created a two-fold challenge to the policy consensus which prevailed when I joined the MPC in the calmer waters of 2006. First, it has challenged the view that monetary policy can keep economies on a steady growth and low inflation track at all times. In the decade and a half prior to the financial crisis, a belief grew up that we were in a “Great Stability” of steady growth and low inflation, with monetary policy playing a key stabilising role in maintaining this state of affairs. Indeed, some policy-makers went so far as to suggest that the era of “boom and bust” was over. That has clearly not been borne out by the record of the last three years, in the UK and many other economies.

The second challenge is to the notion of a simple trade-off between growth and inflation, which seems to underpin much thinking about economic stabilisation in policy-making circles. This approach leans heavily on the idea of the path of inflation being driven by an “output gap” between the current level of activity in the domestic economy and the amount that it could produce if it was operating at capacity. According to this view of the world, stabilising growth and maintaining stable prices required a similar approach to monetary policy. Maintaining steady growth in economic activity close to its sustainable or capacity level should prevent large deviations in the output gap, which in turn should prevent inflation moving away from a low and stable path, as long as inflation expectations remained well-anchored

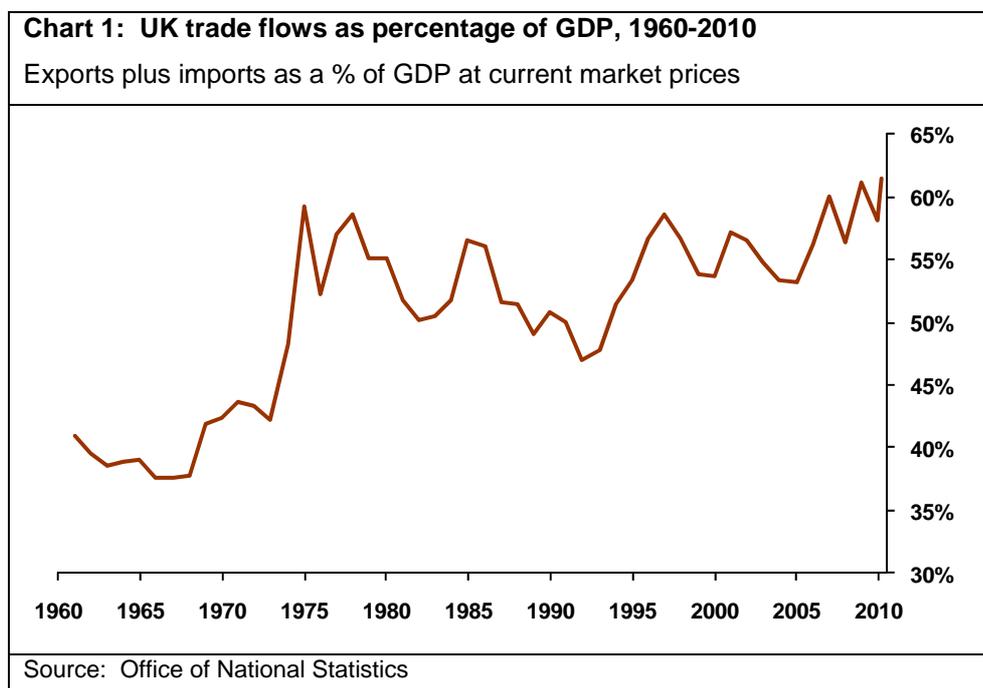
The financial crisis was itself a major challenge to this consensus view that had developed in the 1990s and the early 2000s. But while the crisis can help explain the recession, it cannot easily account for persistently high inflation. To properly understand recent developments in both growth and inflation, we need to view the financial crisis as part of a broader set of global forces making themselves felt over recent years. The UK economy is very open to international trade and investment, and we have a very international business culture with strong links across the Atlantic, to Europe and to the emerging market economies. Because of this, the international dimension is a key ingredient to the setting of UK monetary policy. Indeed, this has not just been a feature of my time on the Committee, but it has been a key theme throughout the life of the MPC since 1997. Before the global financial crisis, the main challenges facing the Committee have taken the form of global shocks – such as the Asian crisis, the bursting of the “dotcom” bubble in the early 2000s and the energy and commodity price rises we have seen from the mid-2000s onwards.

In tonight’s speech, I want to look in more detail at this challenge of operating UK monetary policy in a global context and discuss how the MPC should be responding to the current set of global challenges – a strong rebound in growth across the world economy and upward pressure on energy and commodity prices. I will set out my analysis in three main parts. First, I will present my view of the “new global economy” which has emerged as a result of the forces of globalisation over the past two decades, and which forms the backdrop against which we are seeking to manage the UK economy at present. Second, I will discuss the challenge of stabilising UK inflation in the face of global demand and price volatility – which I believe has become more

difficult because of the changes in the global economy we have seen in recent decades. Finally, I will discuss how my analysis relates to the policy challenges we are currently facing on the MPC.

Globalisation and the “new global economy”

Economists have been talking about the process of globalisation for many decades. Over the last fifty years, flows of international trade and investment have grown steadily in importance in relation to the size of national economies. In the UK, total trade flows – exports plus imports – have risen from about a third of GDP in the mid-1960s to over 60%, as Chart 1 shows. Over the same period, the growing importance of multinational businesses has led to increasing investment flows across borders.

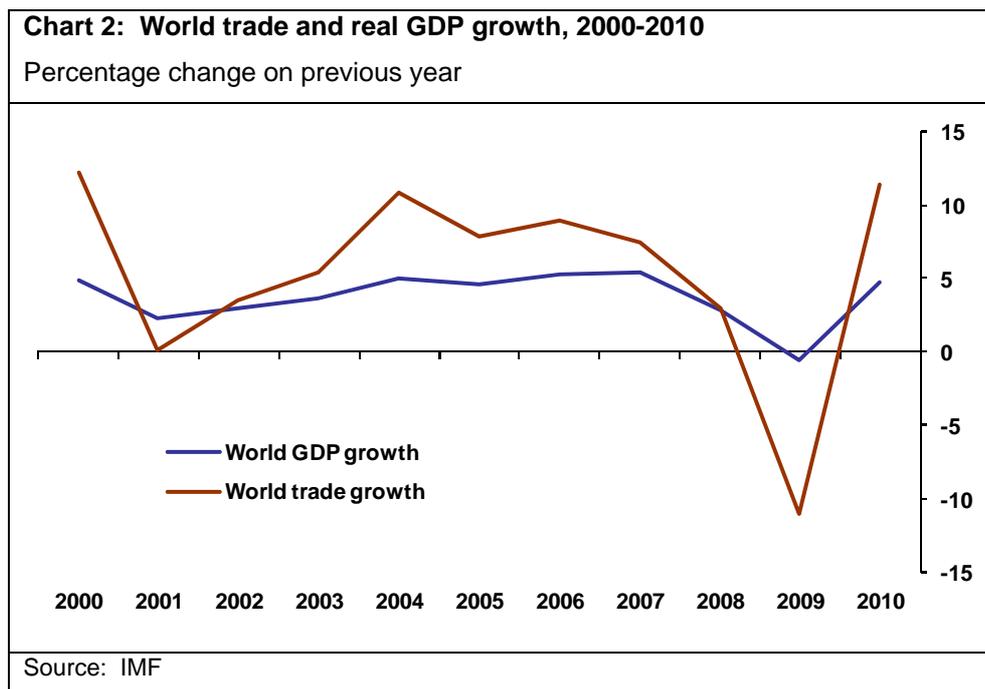


But in the 1990s and 2000s, this process of globalisation has deepened and intensified. The past two decades have seen the integration into the global economy of many emerging market economies, including China, India, Russia and much of Eastern Europe. In addition, the deregulation and liberalisation of financial markets in many countries from the 1980s onwards has created much more globally integrated capital and financial markets, with financial institutions – especially banks – operating on a much more international basis. This deepening and intensification of the process of globalisation has given an added boost to the growth of world trade and economic activity. But it has also extended the globalisation of markets outside the spheres of trade and business investment and into the markets for labour and for capital and finance, creating the potential for greater global economic volatility.³

³ For a broader elaboration of this argument, see Sentance (2009a) and Sentance (2009b)

The recession and the period of growth preceding it has shown this “new global economy” in action as financial markets and trade and investment linkages have transmitted shocks from one country to another and amplified their impact. At the heart of the recession was a global financial crisis triggered by bad lending practices in the US mortgage market. These financial problems had a much more significant and widespread impact because they were transmitted to banks and financial markets around the world through a highly complex and integrated global financial system – affecting credit availability, housing finance and the funding of investment across the world economy.

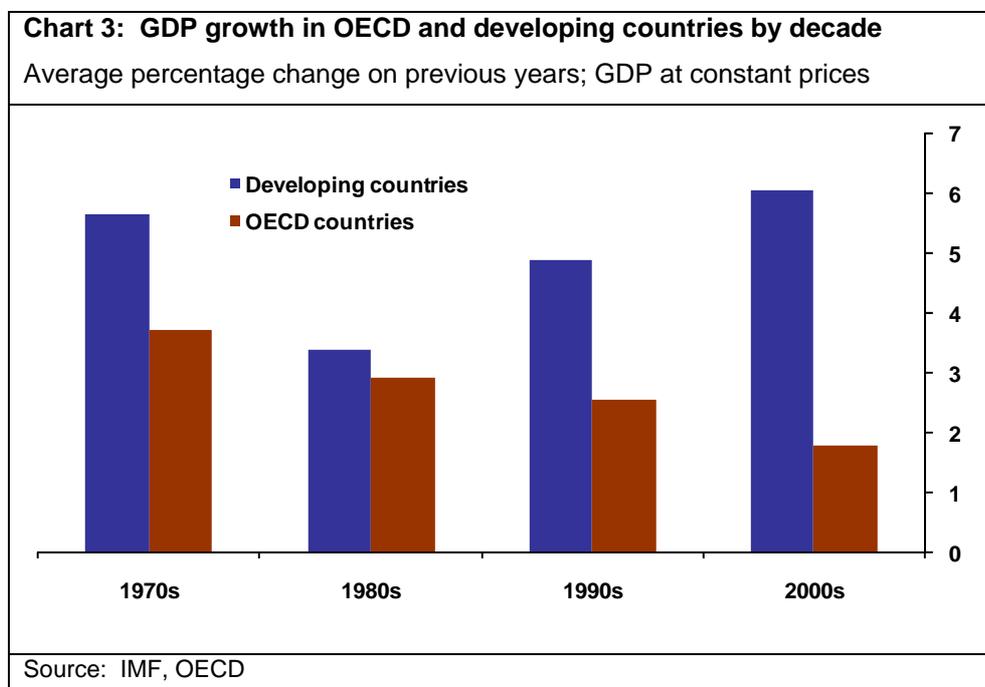
Global linkages also played a key role in driving the recession, by transmitting negative shocks to confidence and financial markets around the world and across sectors, through the highly integrated global supply chains which now exist in the production and distribution of manufactured goods. In late 2008 and early 2009, the downturn in demand triggered a global stock cycle which amplified cutbacks in production in many key sectors of manufacturing, such as the motor industry and IT, creating a very large swing in global trade relative to global GDP (Chart2). Similarly, over the recovery, many countries have seen extremely strong trade growth as the stock cycle has turned and demand has recovered. Global trade flows have recently grown much faster than world GDP as the global stock cycle has turned around and economies have snapped back into life again.



Another key feature of the new global economy, which has resulted from this high degree of interdependence between national economies, is how it has changed the way growth and inflation respond to demand pressures. In a highly integrated global economy, demand pressures can be less easily contained within national borders. They can spill over and affect neighbouring countries – and in the case of

large economies like the United States and China they can affect the whole world. Global inflation trends have also been affected by the entrance of China and other low-cost producers into world markets.

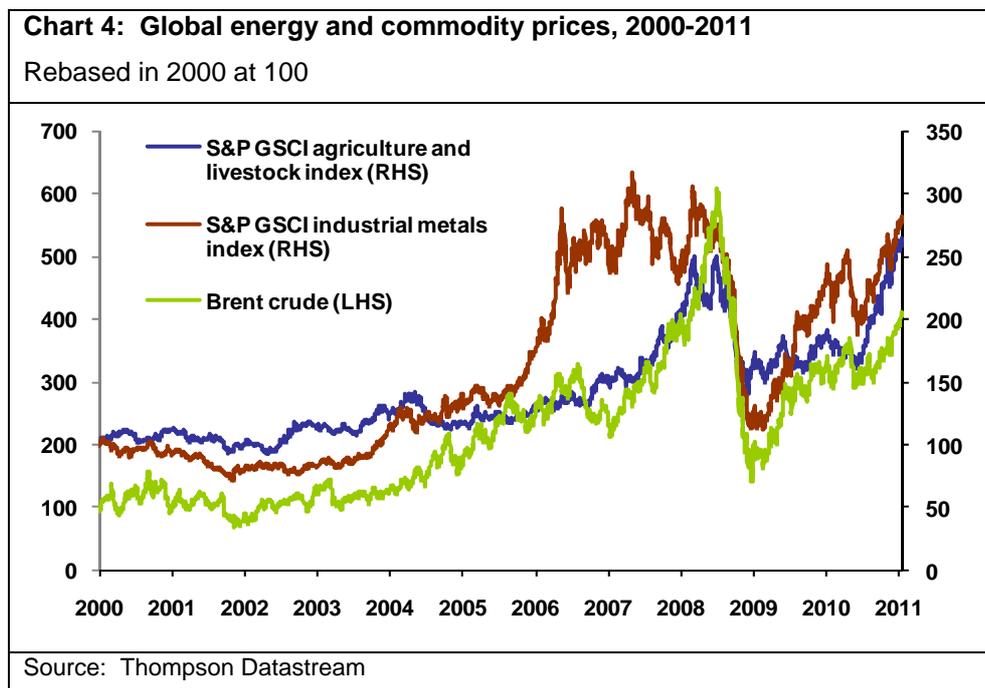
In the 1990s and the early 2000s, we saw a relatively benign aspect of these global trends. A plentiful supply of low-cost manufactured goods from China and other emerging markets dampened the inflationary response we might otherwise have seen from the strong growth of demand in the United States and other economies where demand was being supported by the global credit boom. As a result, the financial excesses in the United States and some other countries in the mid-2000s were not reflected in particularly strong GDP growth or rising domestic inflation. This phenomenon undoubtedly contributed to the “Great Stability” of growth and inflation observed in many economies, including the UK, at that time and played a part in discouraging a monetary policy response to the emerging global credit boom, particularly in the United States.⁴



However, strong growth was experienced over the past decade in emerging market and developing economies. As Chart 3 shows, this created a particularly marked divergence in growth between the advanced economies and the non-OECD world in the 2000s, which appears unprecedented in post-war economic history. Strong growth in resource-hungry emerging market and developing economies has also put upward pressure on the price of energy and commodities since the mid-2000s, as Chart 4 shows. That, in turn, has benefited countries and regions which are major producers of these primary products – giving further momentum to the growth of some developing economies. But these rises in energy and commodity prices are now starting to exert a pronounced influence on global inflation trends more generally. And after a

⁴ For a more detailed discussion of the causes and consequences of the global credit boom, see Hume and Sentance (2009).

short dip in energy and commodity prices in the recession, the upward price trends in these global markets have quickly reasserted themselves in the recovery.



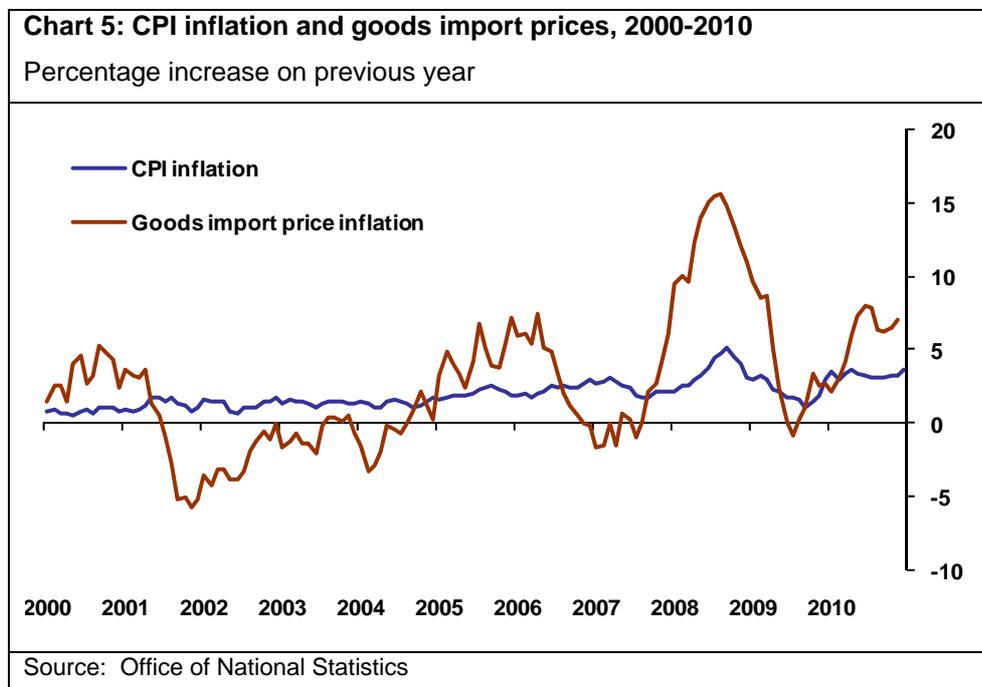
These global developments have also underpinned the international financial imbalances which emerged in the 2000s. The US recorded a significant deterioration in its current account position, with the counterpart of large surpluses in China and among oil and commodity producers. These imbalances have corrected to some degree over the course of the recession as deliberate steps were taken in China and other Asian economies to boost demand to make up for the shortfall in western economies. But as the world economy bounces back from recession, there is now a risk that global demand is too strong. And the strong upward pressure on global energy and commodity prices we are now experiencing can be seen as a warning signal of this shift in the global demand climate.

Global influences on UK inflation and monetary policy

The operation of this “new global economy” has therefore provided the backdrop to my time on the MPC, and has driven the main developments that the Committee has had to respond to. The role of the MPC is to maintain low and stable inflation in the UK – currently defined in terms of a 2% target for CPI inflation. But this task is greatly complicated by the wide variety of ways in which global economic developments impact the UK economy and hence influence our rate of inflation. I believe it helps to think of these in terms of three key channels of influence: import prices; demand; and the pricing climate. Let me discuss these in turn.

It is quite clear in an open economy like the UK that the prices of imported goods and services will affect our rate of inflation – both through their direct effect and as potential competition for domestic producers.

Imports of goods and services are over 30% of UK GDP and Chart 5 shows that we experience much more price volatility from this direction than is typical of consumer prices in general. This chart also shows that the mid-2000s saw a shift from a period of falling import prices to a period over which there has been much stronger imported inflation.

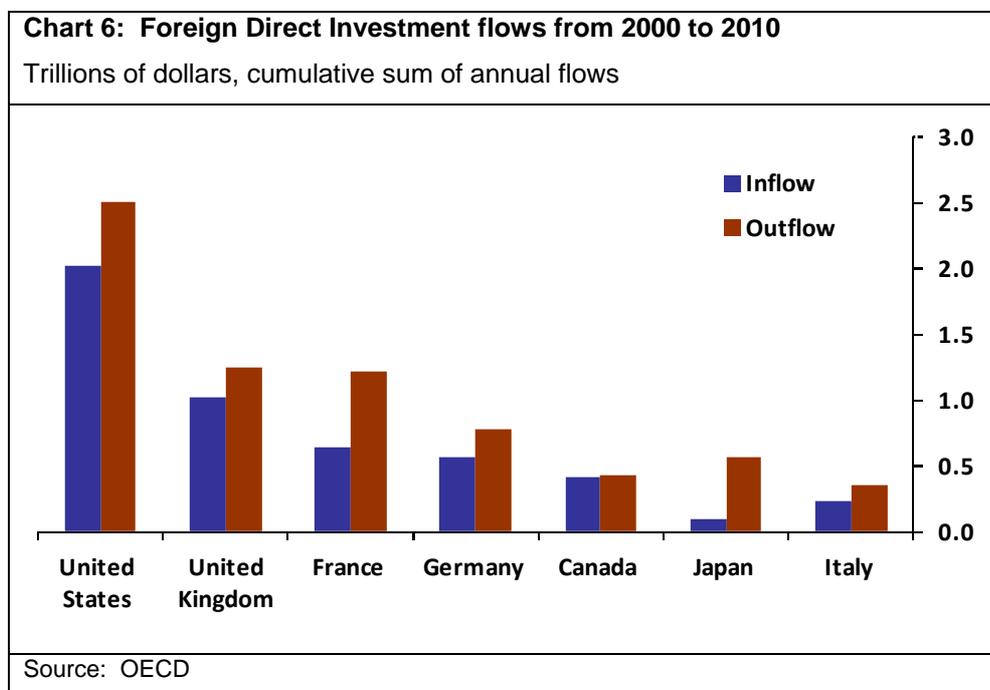


The situation in the early 2000s reflected the downward pressure on the cost of manufactured goods from China and other low cost producers, coupled with the impact of weak global demand associated with 9/11 and other global shocks. The recent upward pressure on global commodity and energy prices also largely reflects the strong growth of demand from Asia and emerging market economies. In both cases, it is trends in the emerging market and developing economies which appear to have shaped global price developments over the past decade, and this pattern looks set to continue into the future.

The second channel of influence from the global economy is via demand. Global economic developments affect demand conditions in the UK both directly and indirectly. The direct influence comes through changes in the demand for UK exports of goods and service. This is a particularly important factor for manufacturing industry, which exports around half the value of its production.⁵ So as the global economy has bounced back from recession, it is not surprising to see this reflected in a strong rebound in UK manufacturing output, which is growing at its strongest rate since the mid-1990s. The services sector is in general much less export-intensive, though some specific service sectors – such as the airline industry and financial and business services – have significant international exposures and tend to be more sensitive to the global demand cycle.

⁵ See Sentance (2007) for more details.

But just as important as these direct linkages to the global economy via exports is the indirect impact of global developments on UK demand. The UK business community is very international, reflecting our tradition as a trading nation and the openness of our financial markets to overseas investment. Chart 6 shows that, apart from the United States, the UK has been the largest major industrialised economy in terms of flows of inward and outward direct investment over the past decade.



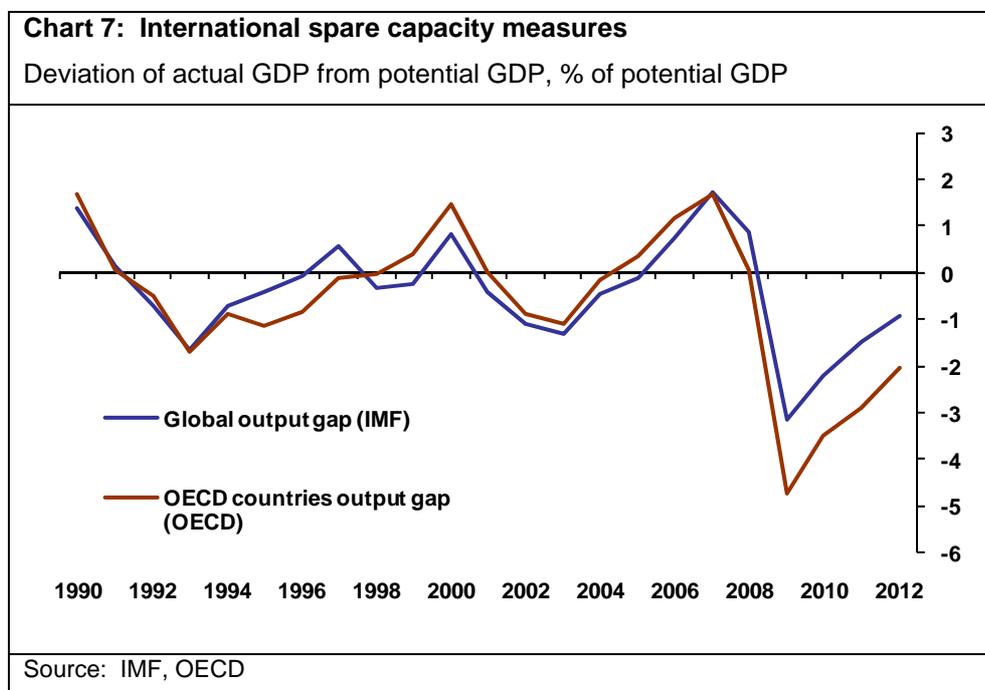
There are also linkages from the global economy to UK demand through financial markets, which have had the dramatic effects we have observed through the financial crisis. And we have also seen in the recent cycle how swings in international business confidence can affect the investment and employment climate here in the UK. In a narrow accounting sense, these swings in confidence can show up in the GDP figures as changes in UK investment and consumer spending. But they are ultimately driven by changes in the global demand climate – impacting our economy because of the widespread activities of international companies here in the UK and our role as a global financial centre.

In addition to these cost and demand impacts, there is a third way in which global economic conditions might also affect UK inflation, which is through their impact on the pricing climate. As businesses become more specialised and international in focus, some economists have argued that global conditions have become increasingly important in affecting pricing behaviour, relative to domestic factors.⁶ According to this view, the global balance of demand and supply and competitive pressures on global markets may come to have a significant impact on prices in economies which are open to international trade, such as the UK. Excess global capacity represents a ready supply of traded goods which can readily enter the UK market, exerting a

⁶ See Borio and Filardo (2007) for a fuller discussion of this argument.

competitive discipline on price increases by UK businesses and holding down inflation. But when global capacity is tight or tightening, this disciplining effect on price-setting may be much weaker.

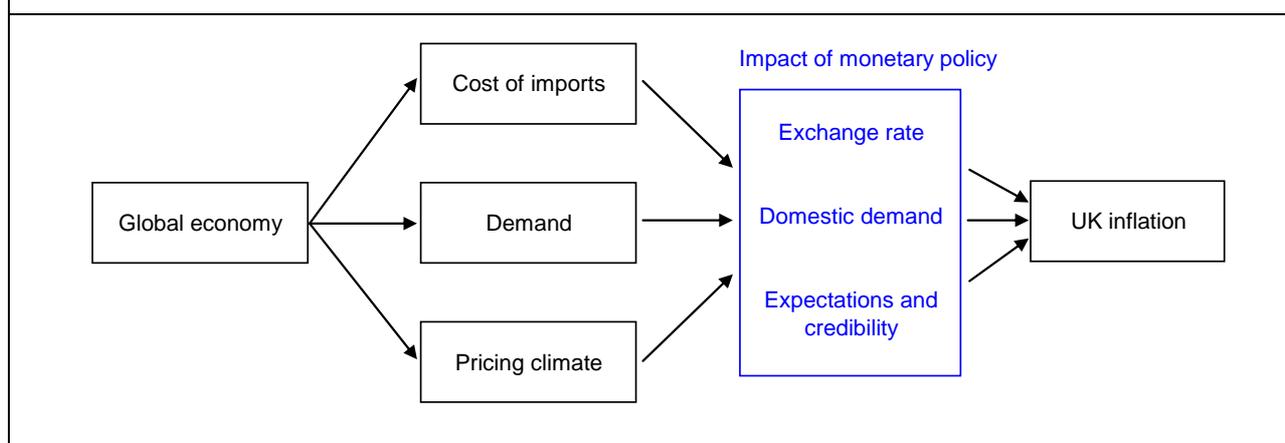
Chart 7 shows measures of spare capacity within the international economy produced by the OECD and IMF, which have moved broadly in the same direction over the last couple of decades. These measures reflect the global capacity pressures many industries were experiencing immediately prior to the financial crisis, followed by the emergence of a large margin of spare capacity as the recession took hold. Both measures now show that a tightening in global capacity pressures is currently underway and is expected to continue through this year and into 2012. These global capacity pressures will have a significant impact on UK inflation, particularly through the prices of manufactures and other goods traded on world markets. We cannot consider capacity pressures on inflation in the UK without taking into account these global influences, alongside domestic measures of spare capacity.



So, inflation, demand and capacity pressures in the UK economy can all be significantly influenced by developments in the global economy. And that has clearly been our experience – particularly in recent years. But monetary policy can still help to stabilise demand and inflation in the face of these powerful global forces. Chart 8 summarises the three main channels of influence through which the MPC can seek to stabilise the UK economy as it is buffeted by global shocks.⁷

⁷ See Sentance (2007) for an earlier discussion of this framework.

Chart 8 Monetary policy, the global economy and inflation



The first of these is the impact of interest rates on the exchange rate. The exchange rate is not directly controlled by monetary policy. But monetary policy has an important influence on foreign exchange transactions – through the effect of interest rate differentials between currencies and the impact of the signals sent by policy-makers on market sentiment and financial flows. Actual or expected monetary tightening should put upward pressure on the exchange rate and have a dampening impact on import price increases, while monetary loosening should have the opposite effect.⁸ Over the medium-term, significant shifts in the exchange rate can also affect the demand climate through their effect on export competitiveness – though this can be offset to some degree by the effect of changing import prices on consumer demand.

⁸ The influence of monetary policy on the exchange rate mainly relies on the uncovered interest rate parity hypothesis. Early empirical tests, relying on short rates and the assumption of rational expectations, rejected this hypothesis in the data. However, once longer maturity yields are used (Chinn and Meredith, 2004) there is much more support for this hypothesis. Similarly, Chinn (2006) finds support for this hypothesis, when the expected change in the exchange rate is measured with survey data, rather than relying on the assumption of rational expectations.

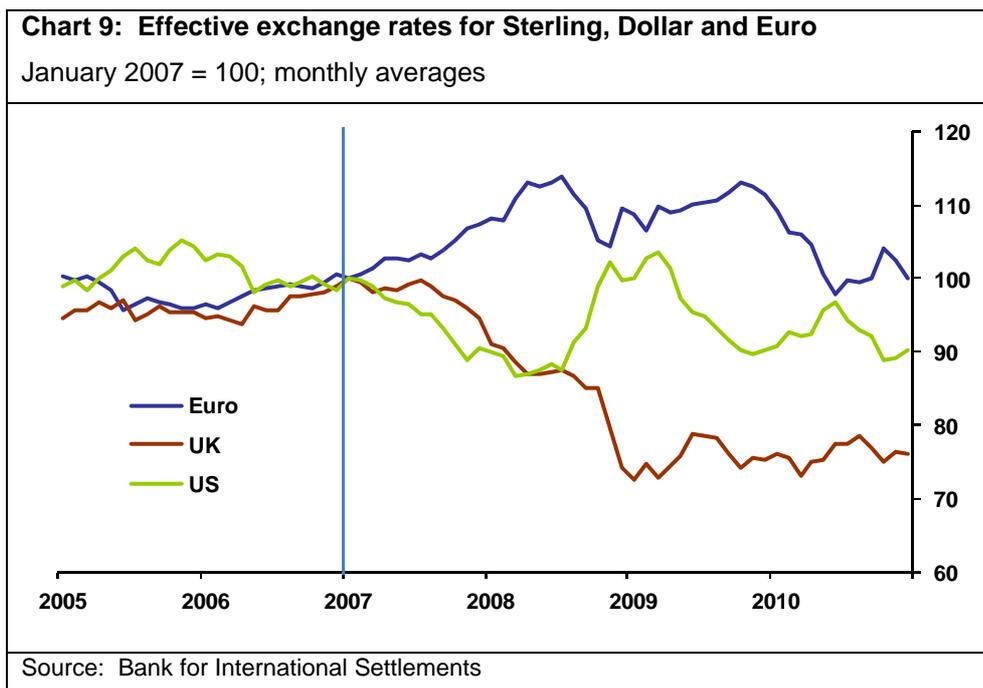
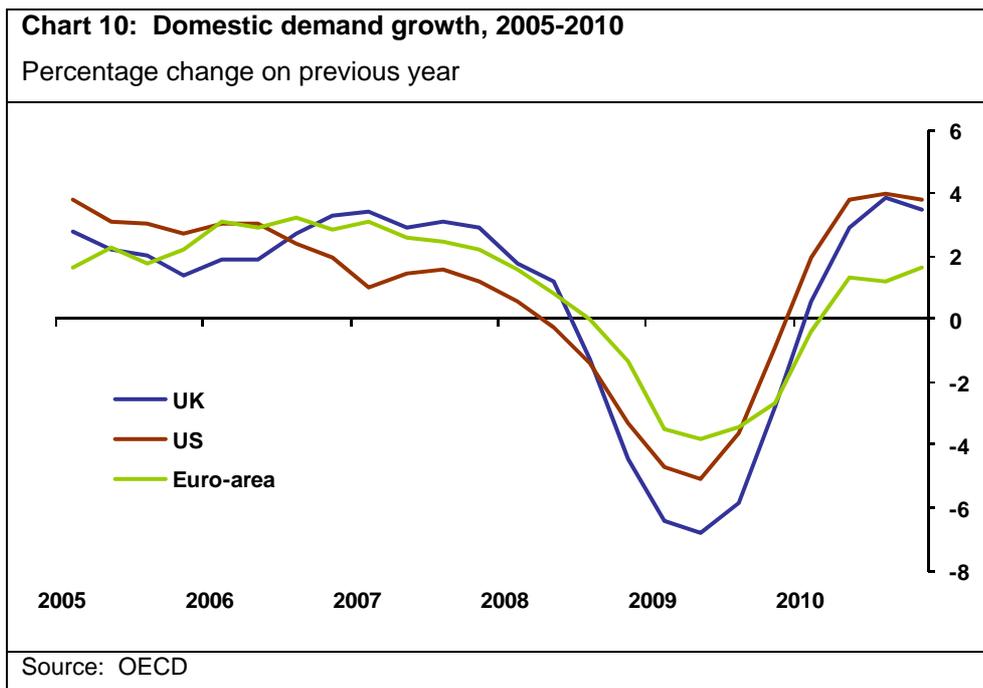


Chart 9 shows that in the period since early 2007, the UK effective exchange rate has depreciated between 20 – 30% against our main trading partners – the euro area and the US dollar. This compares most starkly with the euro effective exchange rate, which is currently broadly in line with its early 2007 value, while the US dollar has depreciated on average by around 10% since 2007. All three currencies have also been affected by the considerable amount of on average volatility we have seen on foreign exchange markets over this period. The implication of this decline in the value of the pound is that the UK has potentially been exposed to much more upward pressure on inflation from import price movements than the US and the euro area. Some of this shift in the exchange rate may reflect a change in the view of economic fundamentals, but the very significant relaxation of monetary policy has also played some part.⁹ And the effect of sterling's decline on inflation will be compounded by the fact that imports are a much more significant influence on the UK economy and consumer basket than for the US and the euro area.¹⁰

⁹ This is most clearly apparent in terms of the relative monetary influences on the pound and the euro since 2007. The reduction in interest rates in the UK has been more significant than in the euro area and the US. Between 2007 and 2009, the Bank of England cut nominal interest rates from 5.75% to 0.5%; this compares to similar figures of 3% to 0.25% for the ECB, and 5.25% to 0.25% for the Federal Reserve. In addition, the Bank of England has also been more aggressive than the ECB with Quantitative Easing. Since March 2009, the MPC has voted to purchase a total of £200 billion of assets, which amounted to approximately 14% of UK 2009 GDP. The ECB has so far purchased a total of €60 billion covered bonds, amounting to less than 1% of euro area GDP. The peak amount of bank debt, mortgage-backed securities and Treasury notes held by the Federal Reserve was \$2 trillion in June 2010 (approx. 14% of US GDP).

¹⁰ UK imports are about 32% of UK GDP, compared with about 16% for the US and the euro area (excluding intra-euro area trade).



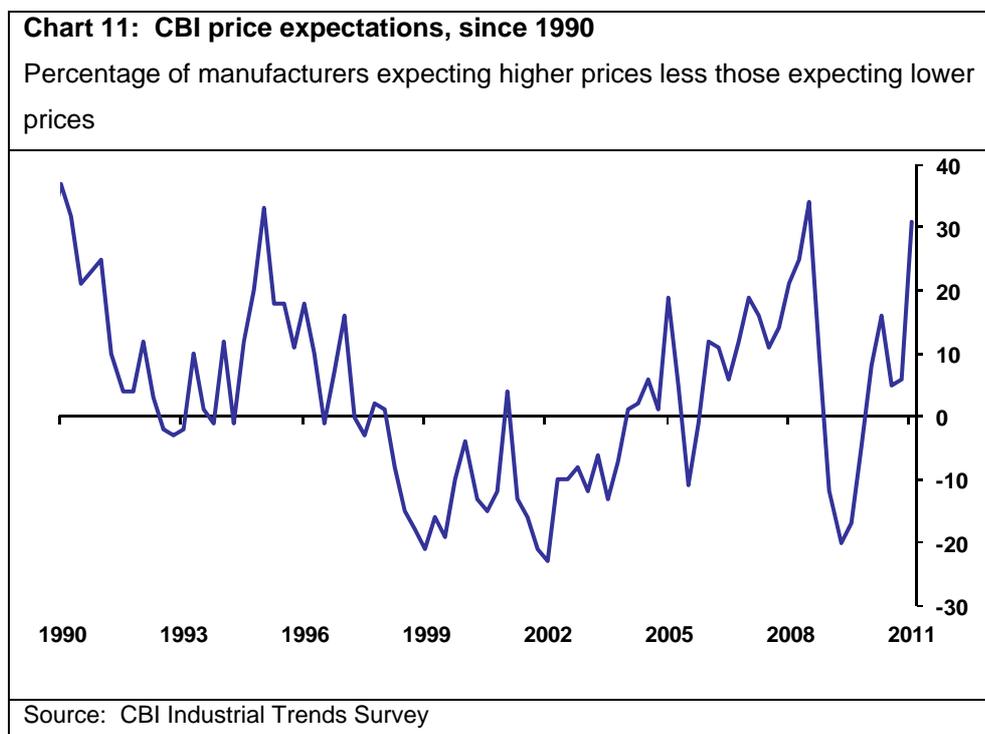
The second way in which monetary policy can counter global economic forces is through its impact on domestic demand – spending by consumers and investment by the private sector, both of which are affected by interest rate changes. As the financial crisis intensified in late 2008 and 2009, domestic demand fell sharply in many economies, including the UK. However, the sharp relaxation of monetary policy in response to the crisis, along with a rebound in confidence and a turnaround in the stock cycle, has supported strong growth in domestic demand over the last year. Indeed, as Chart 10 shows, UK domestic demand has bounced back healthily – almost as strongly as in the US and much more strongly than in the euro area. In real terms, UK domestic demand is 3.7% up on a year ago and in money terms, it has risen by nearly 7%.

In the short-term, this recovery in UK domestic demand is most welcome in helping to lift the UK economy out of recession. But coupled with a resurgence of global inflationary pressures and the additional inflationary impact from the depreciation of the exchange rate, it has also provided a climate in which businesses have been able to pass through price increases without too much fear of losing business. The danger that this poses is that this begins to affect business perceptions of the pricing climate and price expectations more generally.

The credibility of monetary policy and its impact on price expectations is the third stabilising force which monetary policy can exert to maintain stability in the face of global shocks. If inflation expectations remain anchored at or close to the inflation target, disturbances to the inflation path should prove temporary, and it will be easier for monetary policy to ride out a temporary shift in inflation. But when inflation expectations are not well-anchored, it is much easier for an external shock to set off an inflationary wage-price spiral, as we experienced in the 1970s and early 1980s. The task of the MPC in dealing with global inflationary shocks should be made easier by the experience of low and stable inflation which has helped to anchor UK inflation

expectations under the inflation target regime which has operated since the early 1990s. However, if the experience of high inflation calls into question the credibility of the inflation target framework, there is a risk that expectations will drift upwards and a more aggressive policy response will then be needed to ratchet them downwards.

In the immediate aftermath of the recession, in 2009, the main worry in terms of inflation expectations was that they could shift downwards in response to deflationary pressures at home and abroad. Quite rightly, policy-makers around the world relaxed policy and took extraordinary measures – including the injection of £200bn of Quantitative Easing into the UK economy. But the price expectations climate has changed very significantly since then. An example of this is the price expectations responses to the CBI’s latest Industrial Trends Survey, published last week. As Chart 11 shows, there was a sharp jump up in domestic price expectations – the biggest quarterly rise in the expectations balance from one survey to the next since 1968, in the aftermath of the 1967 devaluation. This, along with an upward move in other measure of inflation expectations, is an indication of the upward risks to inflation expectations in the current climate.



Policy lessons and implications

The picture I have described is one in which global factors have a significant bearing on UK inflation and growth. But I have also argued that domestic economic policy can exert a powerful countervailing influence if required. Monetary policy cannot eliminate short-term volatility in terms of growth or inflation. But it can ensure medium-term price stability, through its influence on the exchange rate, the level of demand and price

expectations. That, in turn, provides a sound platform for sustained economic growth, though in the context of major global shocks we cannot guarantee that growth will always be steady and smooth.

In the analysis I have set out I have made relatively little mention of the domestic “output gap”, because I find this a rather narrow way of thinking about how the demand climate affects inflation in an open economy like the UK. The margin of spare capacity in the domestic economy, which output gap measures seek to capture, can have a bearing on inflation processes. But it is only one element of the way in which the demand climate affects inflation. The growth of domestic demand, global demand and the global capacity gap are also significant for an open economy like the UK. And looking beyond demand, the global inflation climate, the exchange rate and inflation expectations are also significant influences on our inflation rate, not just in the short-term but in the medium-term too.

The downward impact on inflation of spare capacity in the domestic economy is likely to be most noticeable in the recession or immediately after it. However, we have not seen much evidence so far that the margin of spare capacity is bearing down significantly on UK inflation. Our target measure of inflation – the consumer prices index – has continued to run above the 2% level despite forecasts that it would be driven below target by the recession. And it looks set to rise further this year. There are many explanations for above-target inflation, including the impact of the exchange rate and one-off price shocks. But other evidence points to the conclusion that the margin of spare capacity as we emerge from recession is less than simple models would suggest. This is perhaps not surprising, as estimates of the level of GDP and its trend rate of growth – which are key inputs into measures of the “output gap” – are notoriously prone to revision, particularly around the time of recessions.¹¹ And many business surveys – such as the CBI Industrial Trends Survey – suggest that the margin of spare capacity within firms is already back in line with historical norms. The rate of unemployment has not risen as sharply as after the recessions of the 1980s and the 1990s, when it had reached over 10% at this stage of the cycle. This better employment performance is welcome, but it means there is less slack in the labour market than coming out of previous recessions, with a heightened risk that wage increases will pick up with the recovery.

The UK Monetary Policy Committee quite rightly has an emphasis on the medium-term, and trying to look through short-term disturbances to inflation. I think this is entirely correct, but it would be a mistake to label all the global factors affecting inflation as one-off short-term disturbances and to see the medium-term influences purely in terms of domestic factors, such as the rate of growth of domestic money supply or wage growth. The UK economy is sufficiently open to international influences that our inflation outlook can never be purely a product of domestic factors. Properly taking into account the influence of the international economy is the key to the art of successful management of UK monetary policy.

¹¹ The picture of the early 1990s recession and early recovery has altered significantly with data revisions. The real-time data show a level of output around two-and-a-half years after the peak much closer to the comparable level in the early 1980s and in the 2008/9 recession, with a bigger fall in GDP during the recession and a slower recovery.

In my analysis, I have also highlighted the importance of the exchange rate in the transmission of global shocks to the UK economy, and as a potential countervailing influence to global inflationary pressures. We have experienced attempts in the past to stabilise UK monetary conditions through an exchange rate link to another currency – the US dollar in the 1950s and 1960s and the Deutsche Mark, from the mid-1980s until 1992. This most recent period of targeting the exchange rate was not a success for the UK, and we have had much better economic performance under our own inflation target regime. But nor can we ignore the effect of a large depreciation of the exchange rate on inflation, if it feeds through into a wider perception in the business community that price increases can now be passed through more easily – not just for a while but in the future too. In this sense, the recent jump in CBI price expectations and other elevated measures of business price expectations are worrying signals. They are an indication of a change in the pricing climate which may make it more difficult to achieve low inflation when some of the current price shocks have passed.

In my view, the MPC needs to steer a middle course when it comes to global pressures on inflation. We should be prepared to look through genuine one-off shocks. But when it is clear that global inflationary pressures, coupled with a substantial decline in the exchange rate and reasonably healthy growth of domestic demand are all contributing to a sustained period of above-target inflation, then the time has come to act. As I have argued in recent months, if we do not start to raise UK interest rates gradually soon, we risk having to do so more aggressively in the future – which could create a big shock to business and consumer confidence further down the track. The lack of a substantive policy response to persistent above-target inflation also enhances the risk of a loss of credibility in the inflation target itself and a loss of belief in the commitment of the MPC to achieving it.

In the late 1990s and the early 2000s, monetary policymakers in the UK could rely on a benign global inflation climate in which a growing world economy was accompanied by falling manufactured goods prices as China and other low-cost producers made their mark in the global economy. That is no longer the world we inhabit. As I argued in a number of speeches before the global financial crisis, this global disinflationary phase came to an end in the mid-2000s. Since then, it has proved much harder to stabilise UK inflation in the face of upward pressures on inflation from the global economy, which have been reinforced by the decline in the value of the pound since 2007.

I believe we can steer a low inflation course through current global economic turbulence, just as monetary policy sought to counter the negative shock from the global financial crisis. But to do so, we need to be prepared to adjust the settings of policy to reflect the change in the balance of risks in the world economy, which have shifted significantly over the past eighteen months – from recession to recovery and from global deflation to global inflation.

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