

Bank of England

UK inflation: What's done and what's to come

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Excellence (ESCoE)**

[Full text of speech](#) and [supporting research paper](#) on Bank of
England website



1. Some questions about inflation, uncertainty and the future
2. A model
3. Accounting for past inflation using the model
4. Real-time policymaking under uncertainty
5. Inflation prospects

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Four questions...and answers

1. What caused the pandemic-era inflation?

- External shocks?
- Too much demand for too long/BoE asleep at the wheel?

External shocks

2. Why were the 1970s so different?

- A much smaller energy price shock in the 1970s...
- But inflation persisted for much longer

Flexible labour markets,
well-anchored expectations

3. How do you make policy in real-time?

- Data uncertainty, hindsight...

Labour market case study

4. Future prospects

- Interest rates?
- Bank credibility

I would rather hold rates until there is more certainty that underlying inflationary pressures have subsided sustainably.

1. Some questions about inflation, uncertainty and prospects for inflation

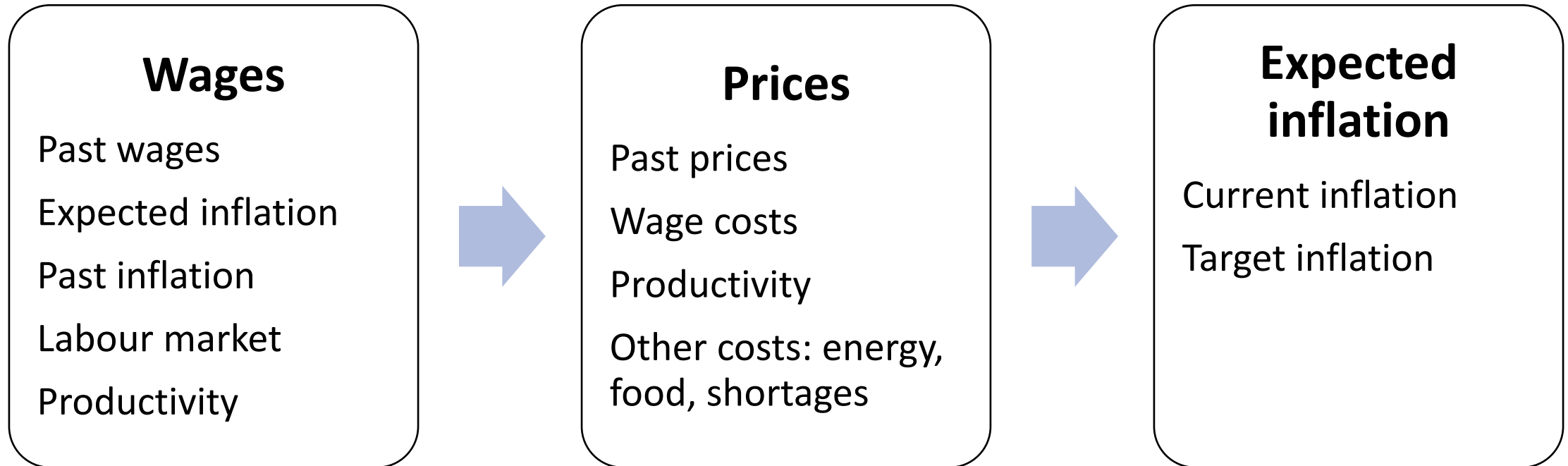
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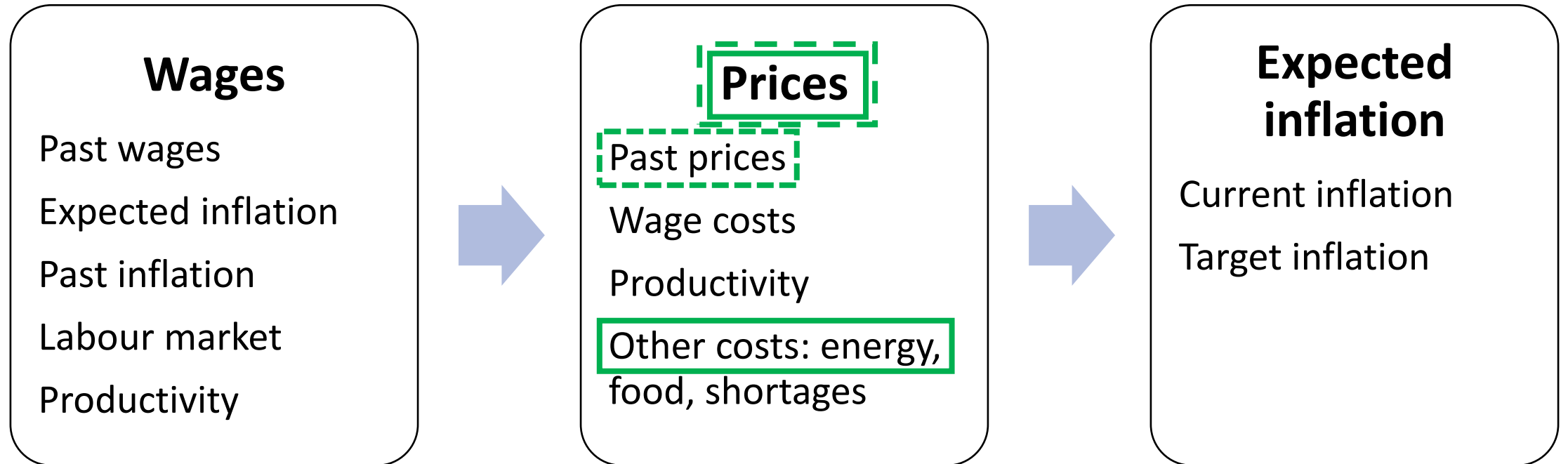
5. Inflation prospects

The Bernanke-Blanchard model (simplified)



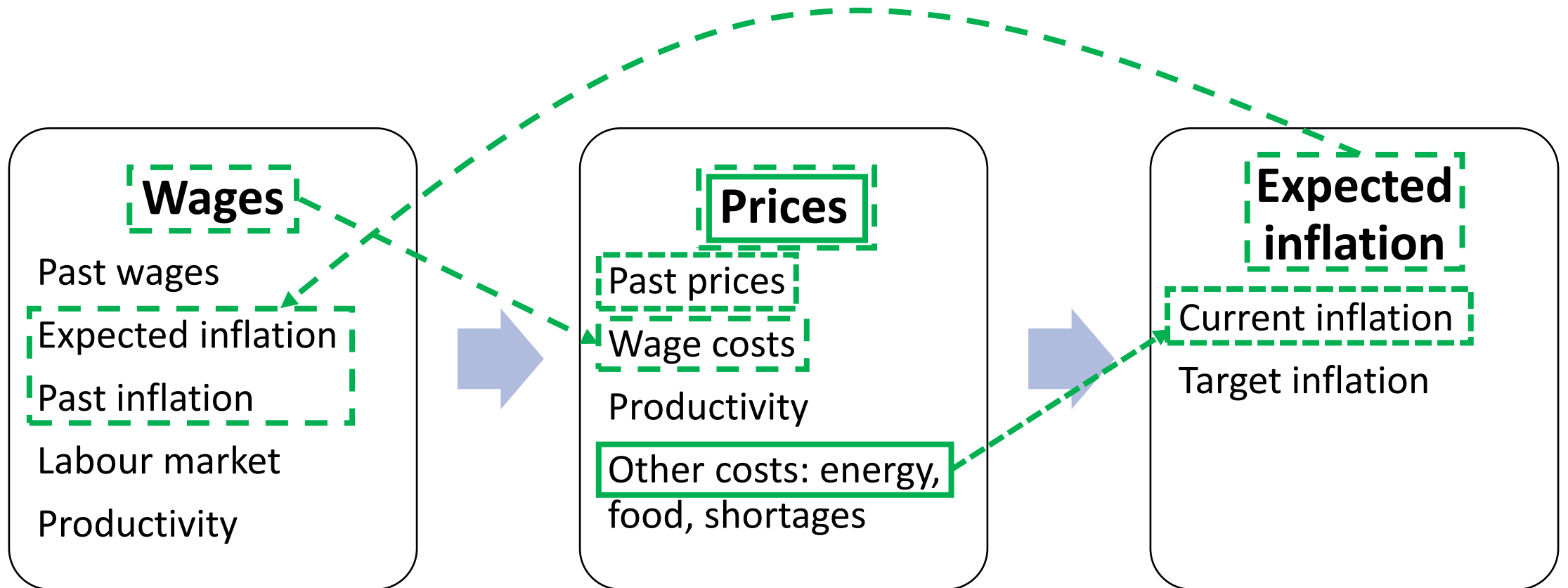
The model in action – energy price shock

First-round effects



The model in action – energy price shock

...and second-round effects

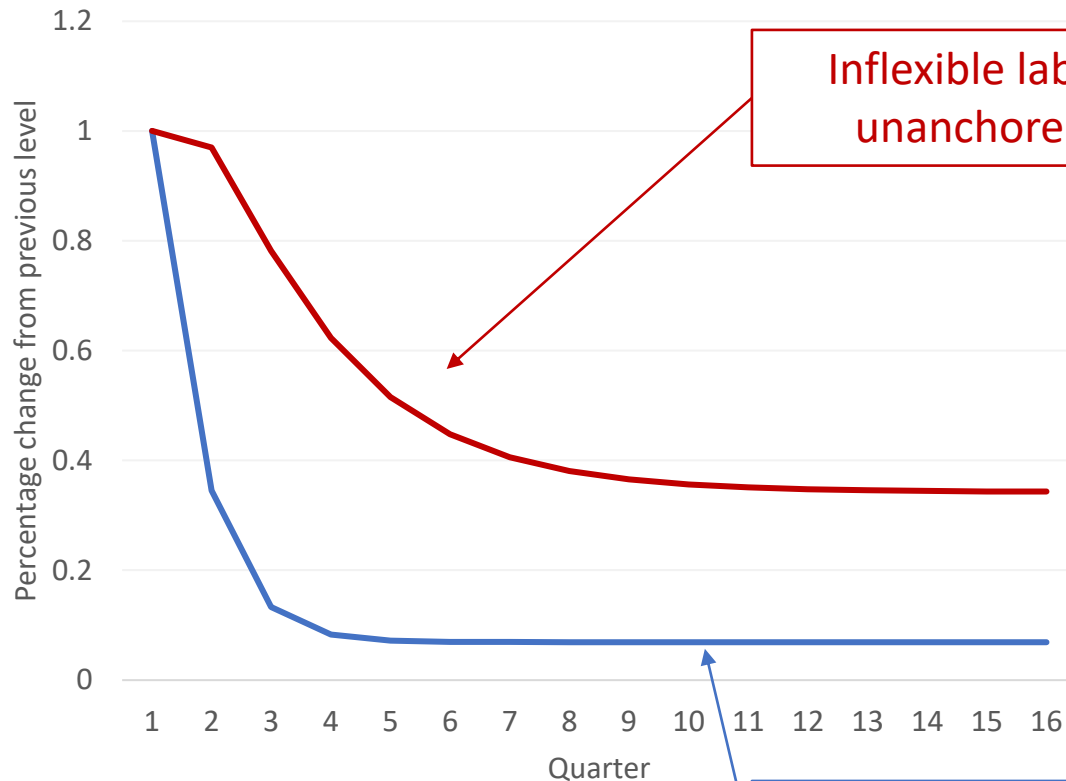


Two economies

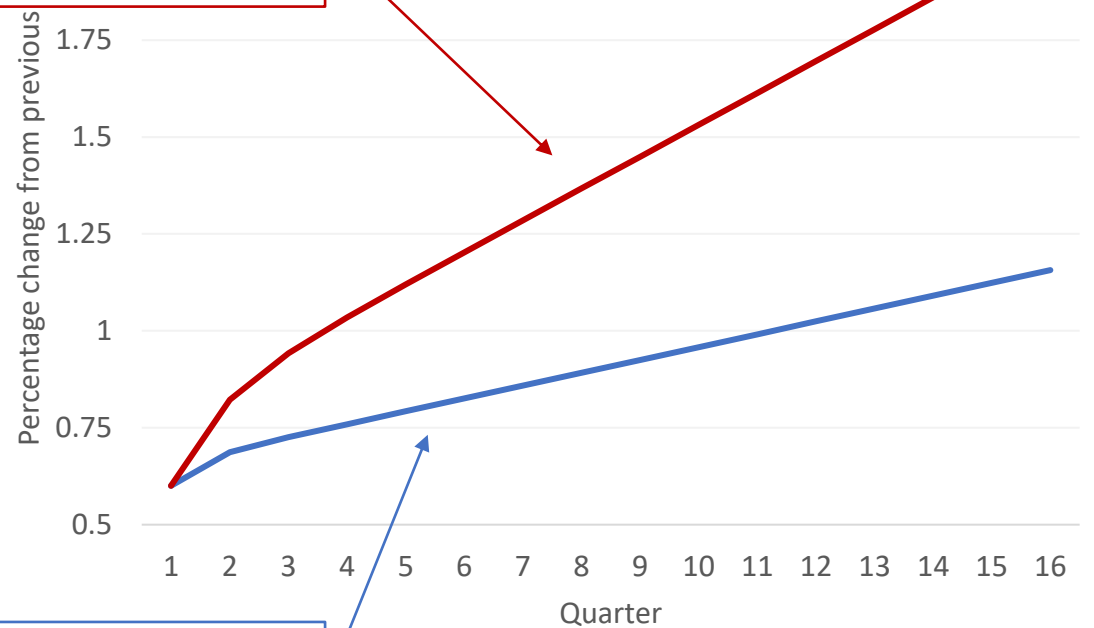
Persistent and transitory second-round effects

Response of inflation to a permanent shock to the price level, alternative parameter choices

Response of inflation to a permanent increase in labour market tightness, alternative parameter choices



Inflexible labour market and unanchored expectations



Flexible labour market and anchored expectations

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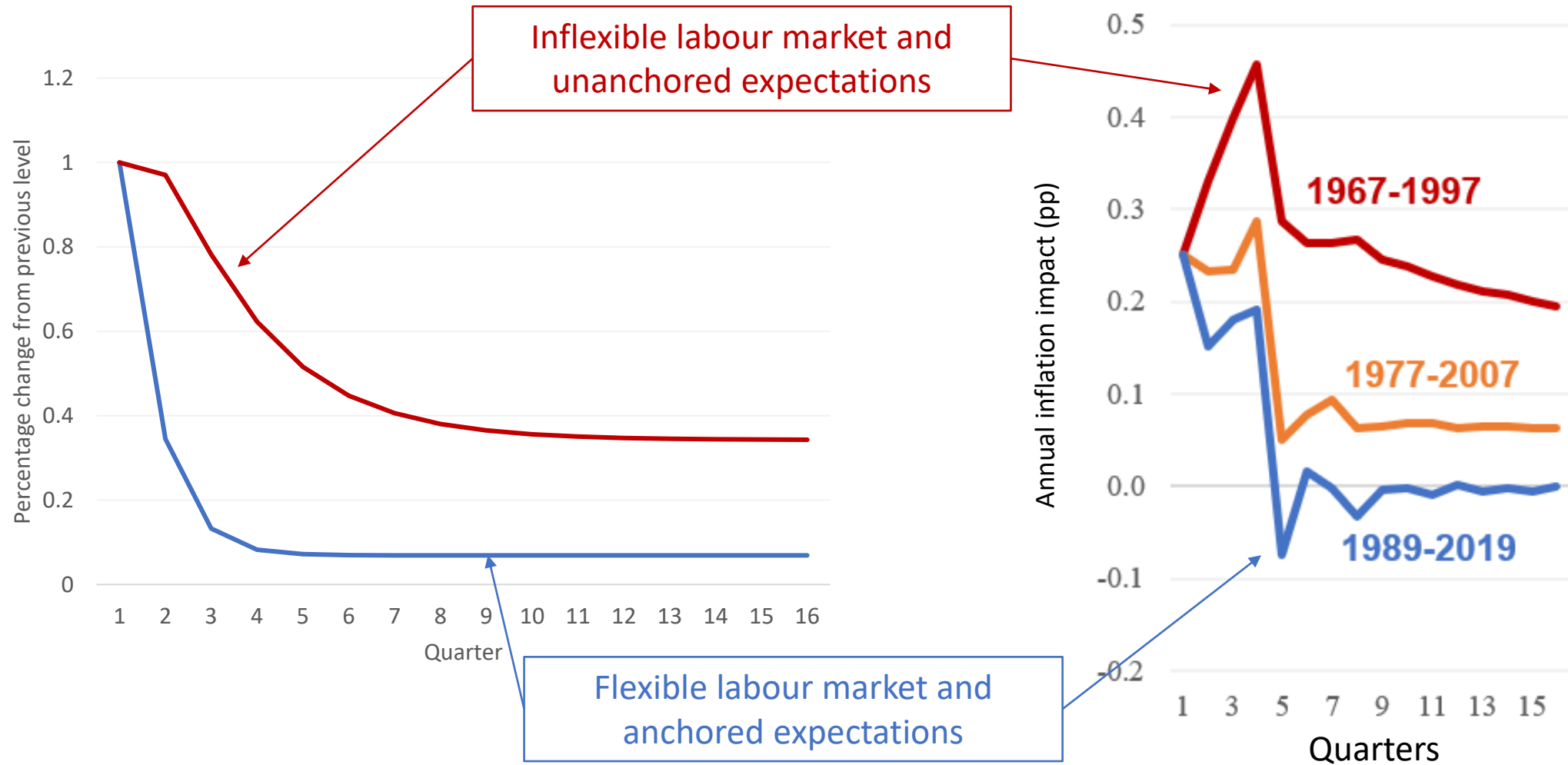
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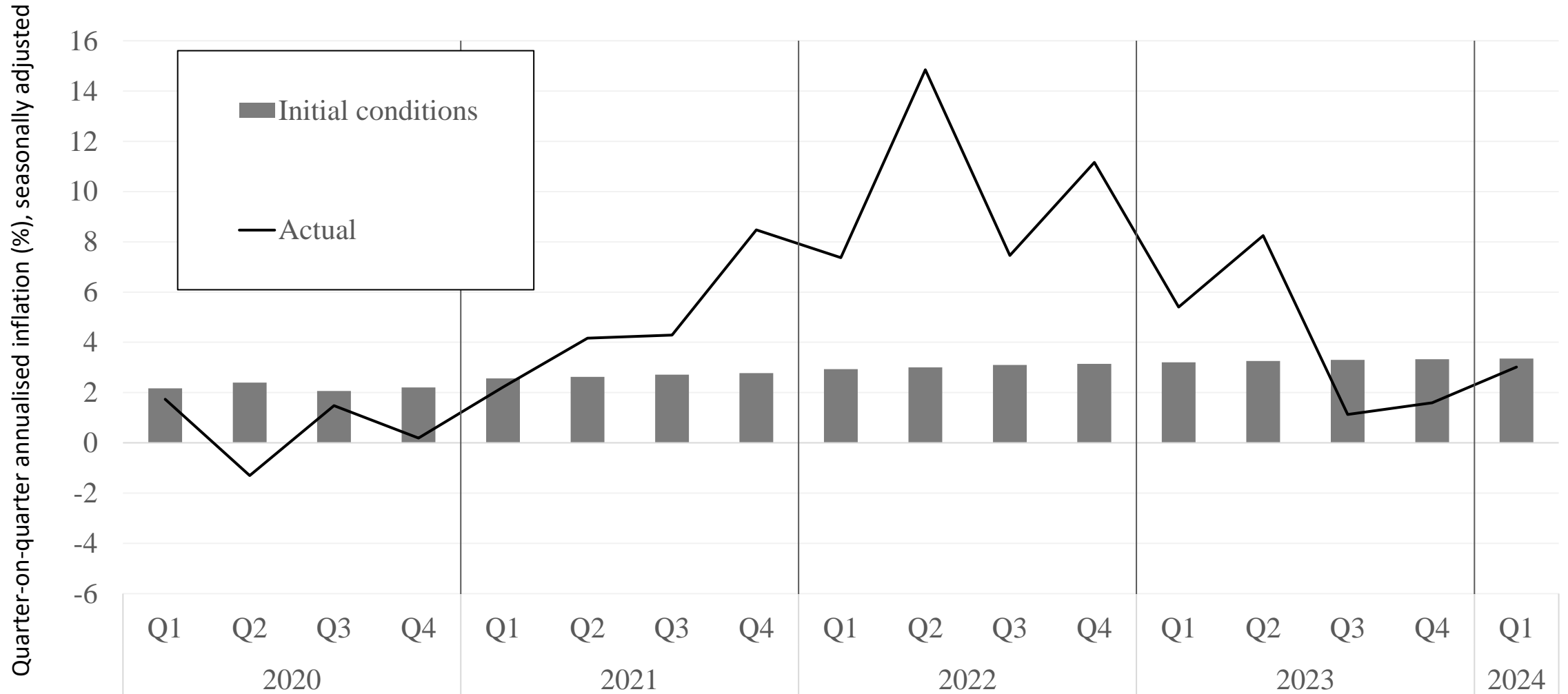
1970s versus today

How does the economy respond to unexpected energy price rise?

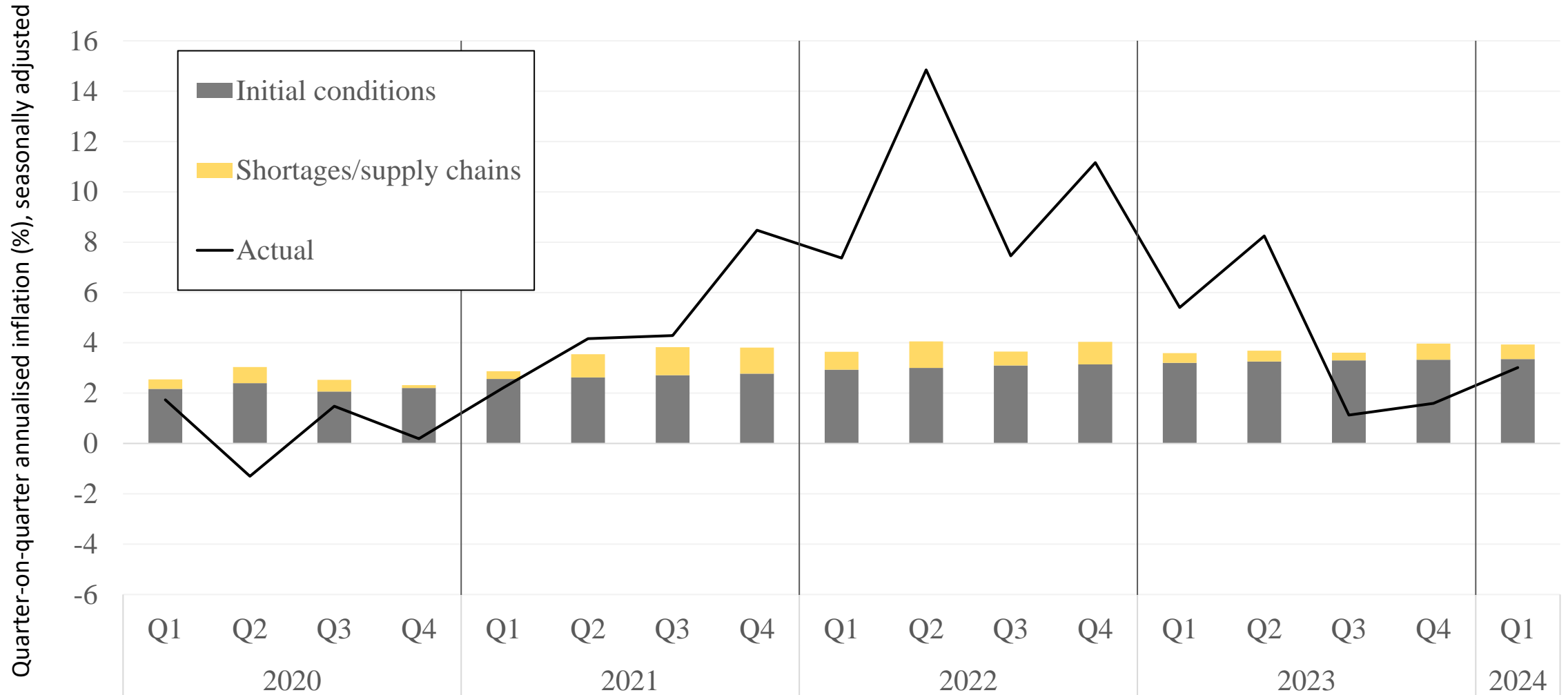


Accounting for recent inflation

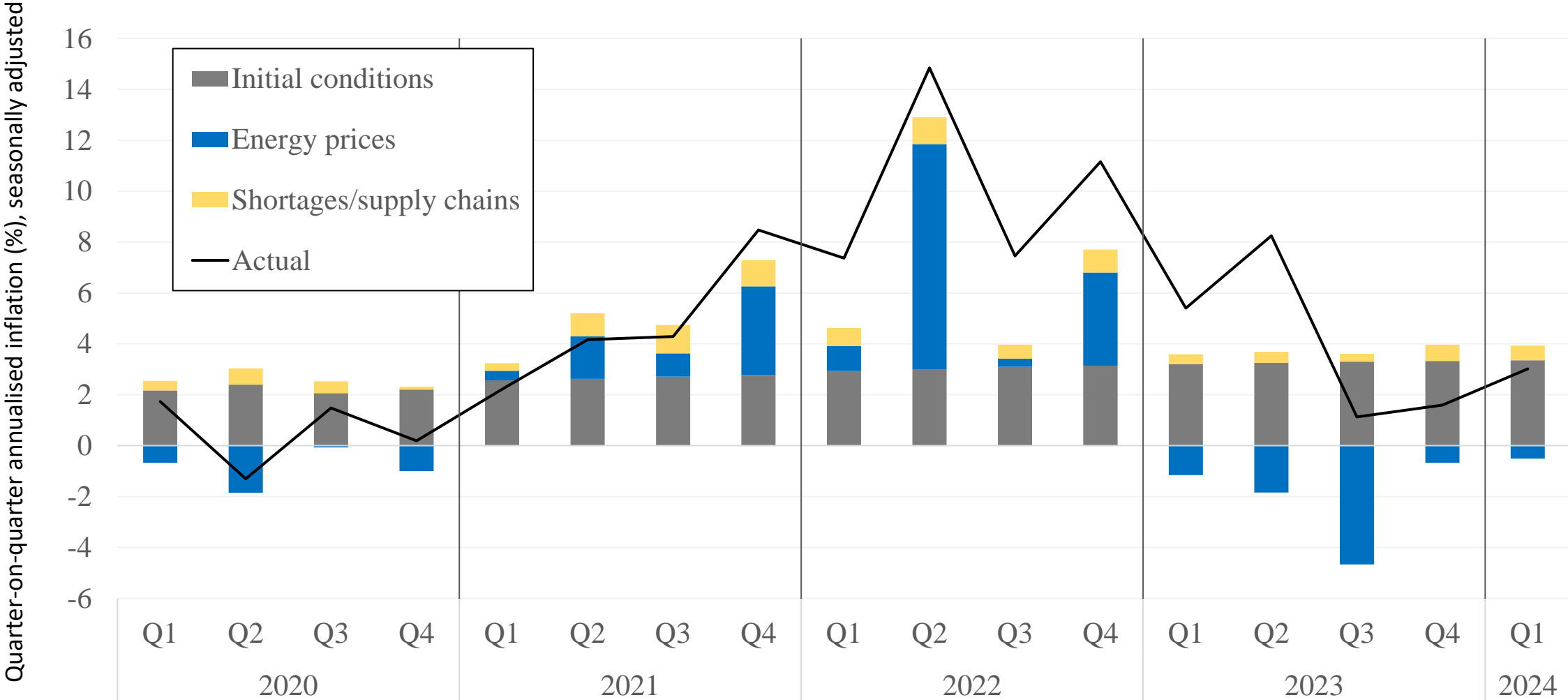
Recent inflation 1: Pre-pandemic labour market



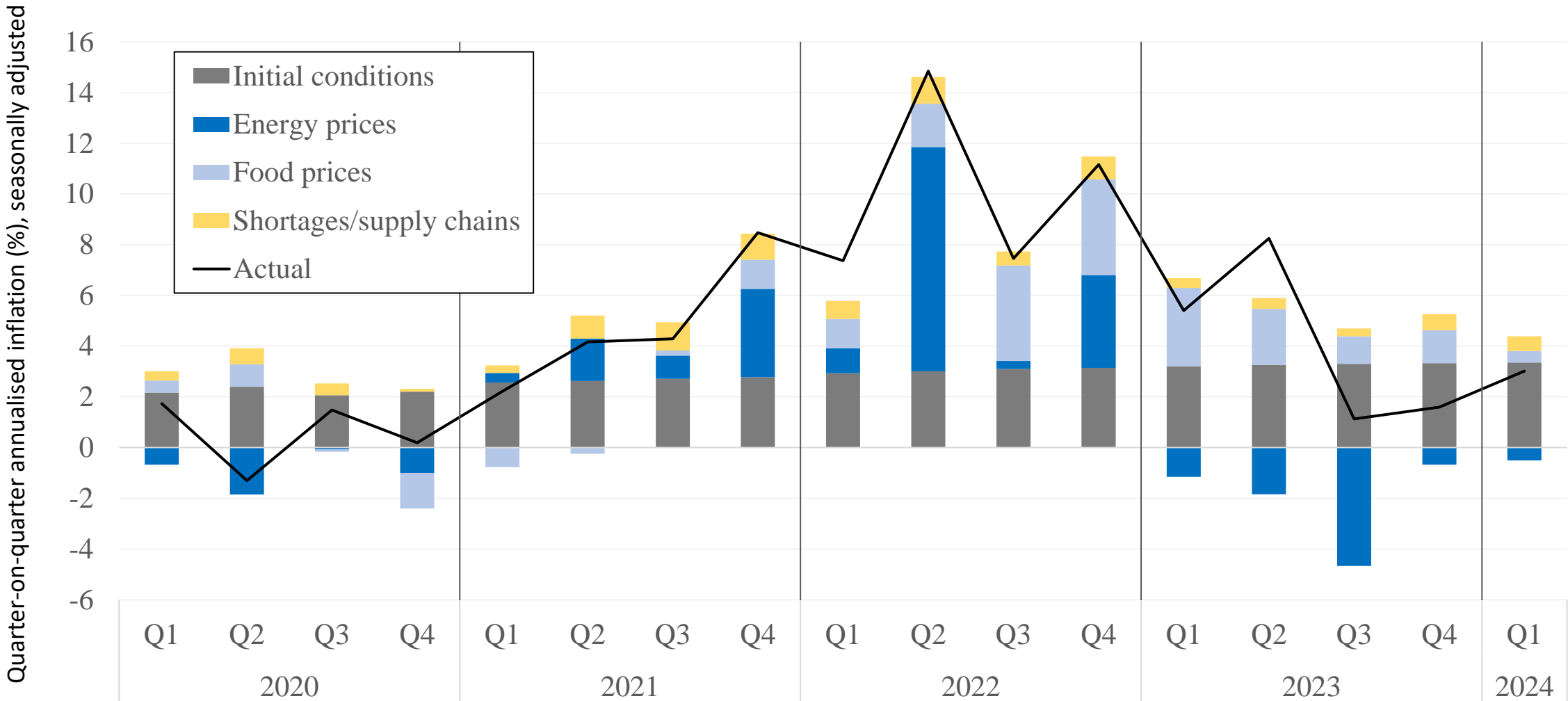
Recent inflation 2: Shortages/supply chain disruption



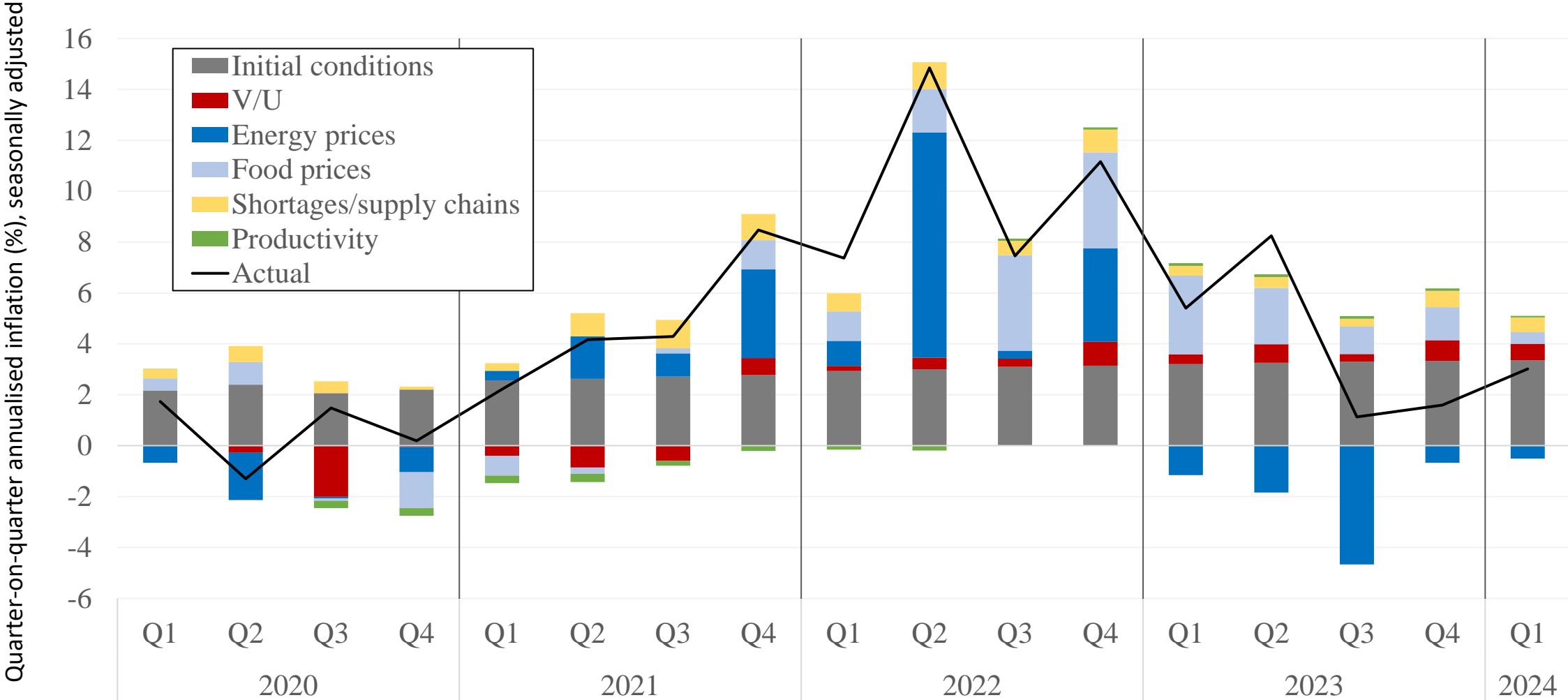
Recent inflation 3: Energy prices



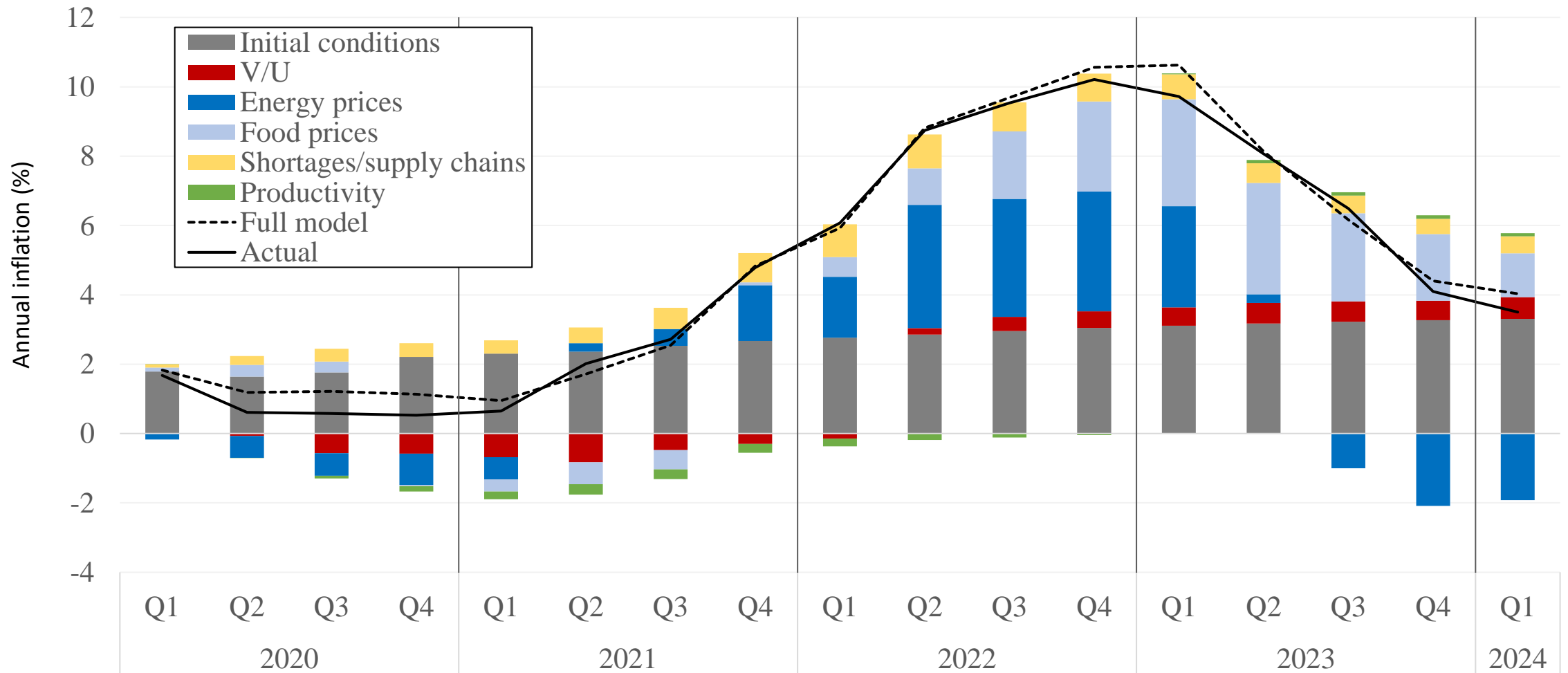
Recent inflation 4: Food prices



Recent inflation 5: Tightening labour market



Decomposition of annual UK inflation, 2020 Q1 to 2024 Q1



Annual transformation of previous quarterly chart

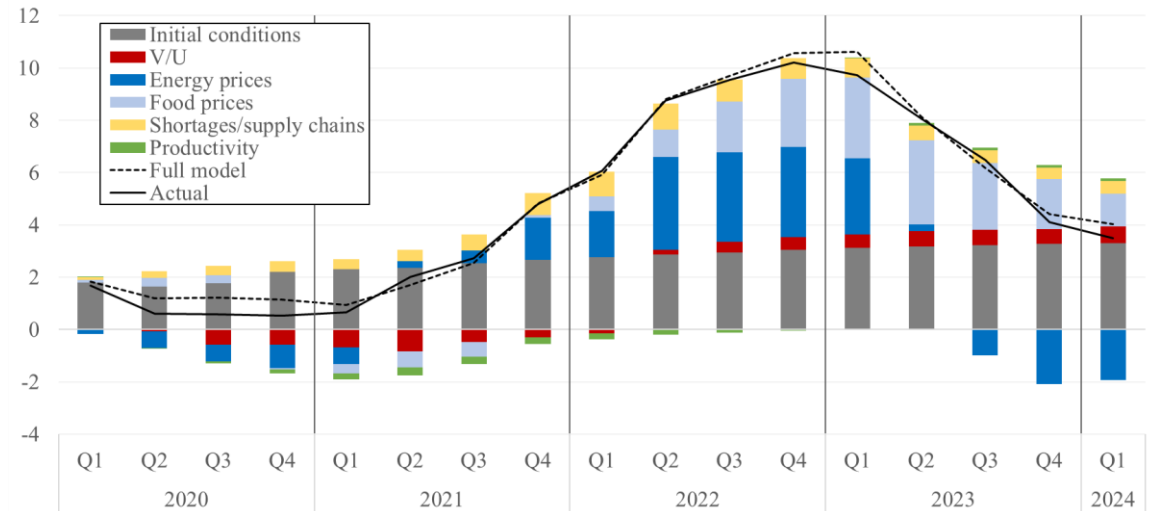
Summary of the pandemic-era inflation

- ✓ Large and repeated price shocks
- ✓ With second-round effects
- ✓ And a tight labour market

x Money supply

x Greedflation

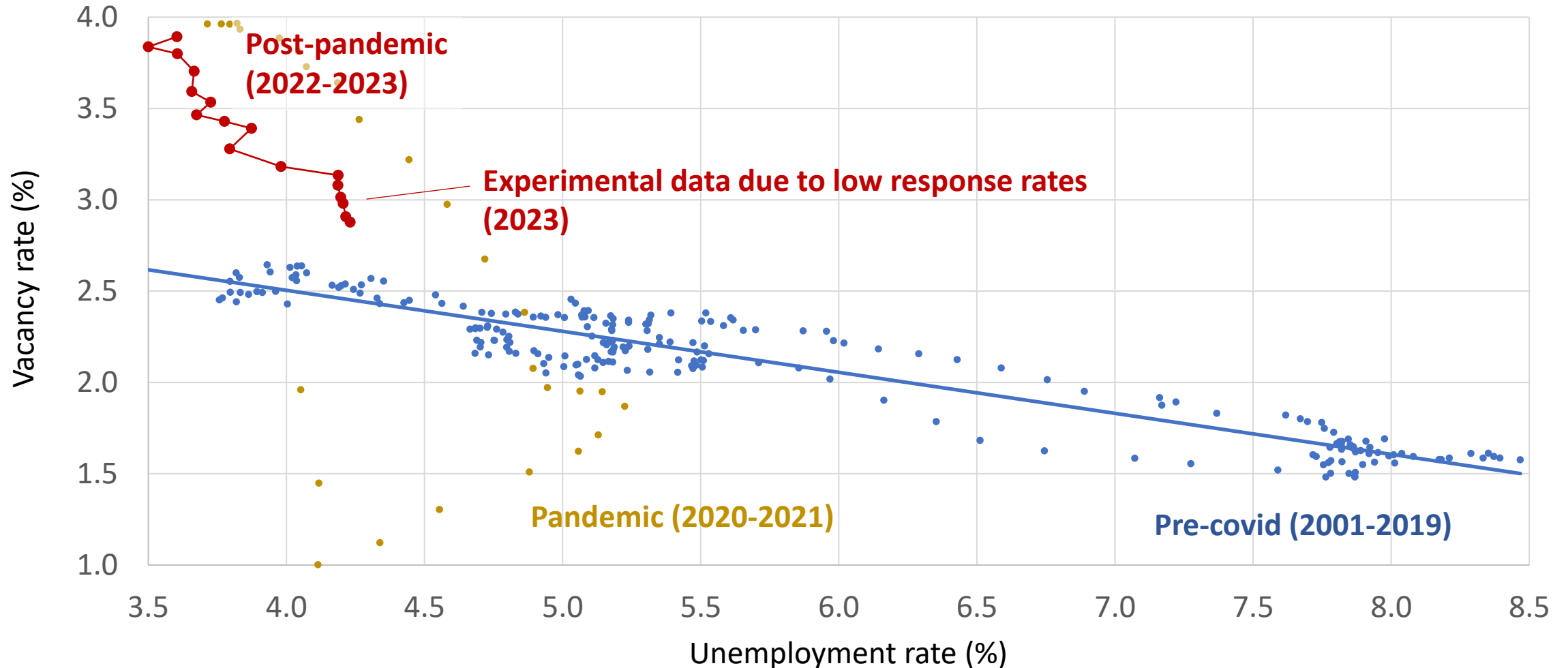
x No rate rise needed



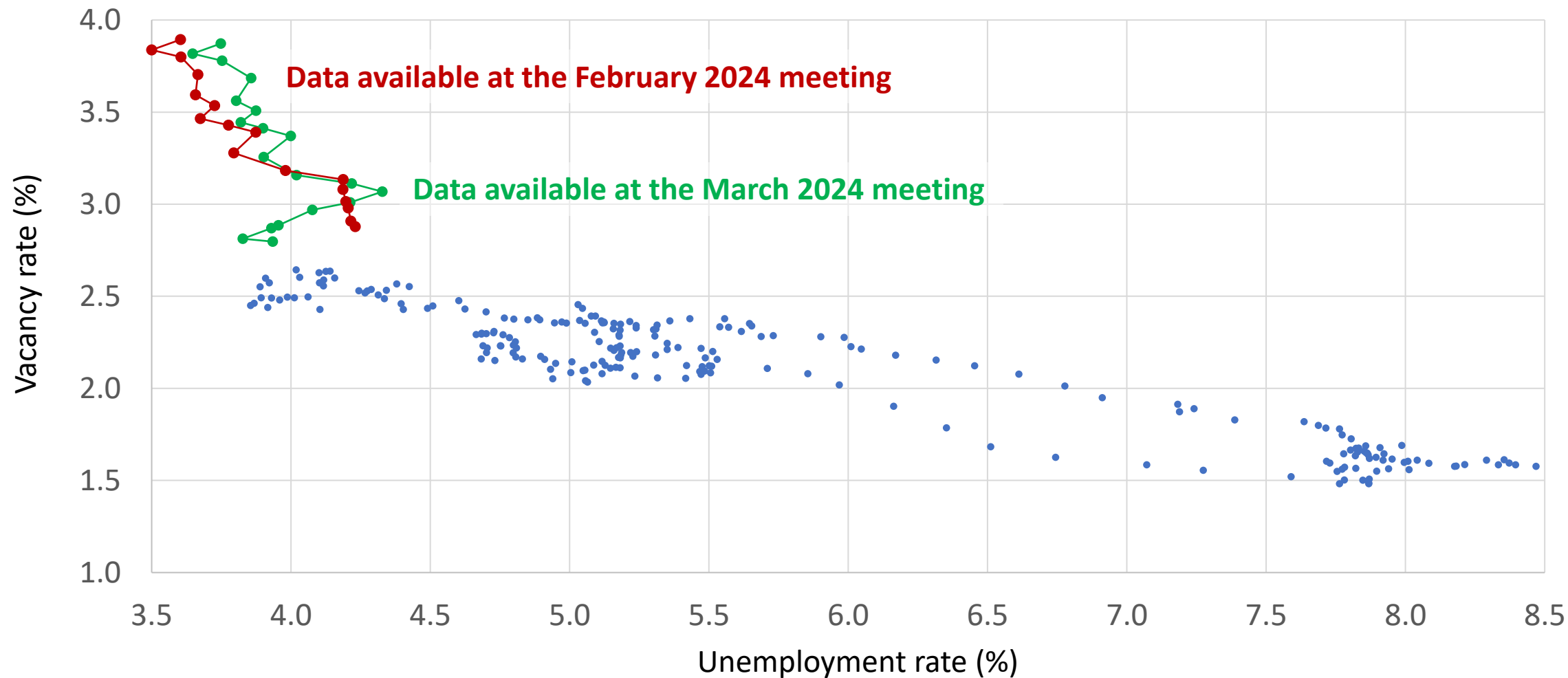
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Polycymaking in real time – a case study, 1/2

Data available at February 2024 meeting



Polycymaking in real time – a case study, 2/2

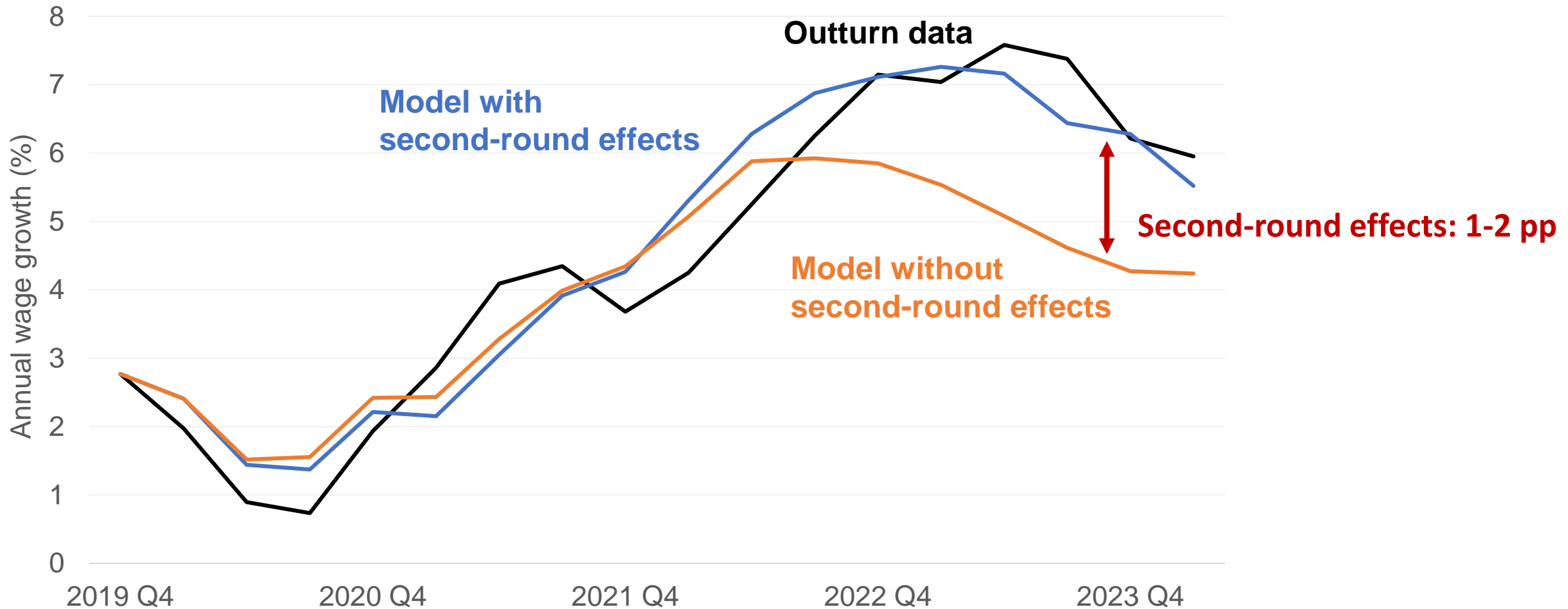


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The Bernanke-Blanchard model... wages with no second-round effects



Second-round effects have pushed up wage growth by 1-2pp



Conclusions

- **The past:** pandemic-era inflation = price shocks + second-round effects + tight labour market
 - The Bank was not behind the curve
 - ESCoE can help!
- **The future: near term**
 - Labour market still tight. Second-round effects still playing out.
 - I would rather hold rates until there is more certainty that underlying inflationary pressures have subsided sustainably
- **The future: medium term**
- Central Bank credibility/trust: intangible asset
- Investing in “trust”: political science.
 - **Integrity:** stick to promises.
 - Independence
 - **Ability:** competence.
 - Missing targets? Bernanke review.
 - **Benevolence:** intrinsic motivation
 - Hawks and doves
 - Models and data