

# Monetary Policy and the Markets

National Association for Business Economics

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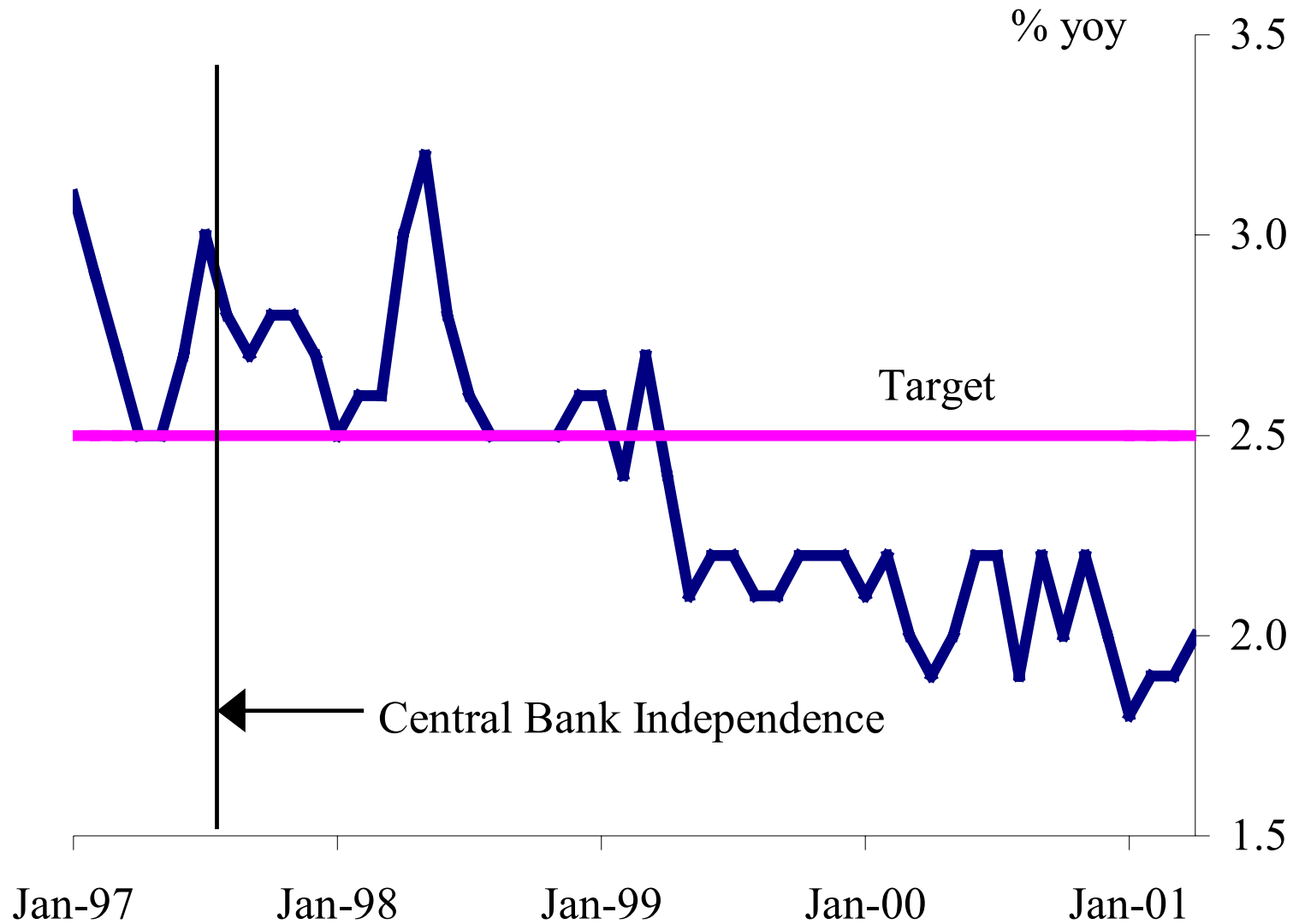
Bank of England

# UK Monetary Policy Framework

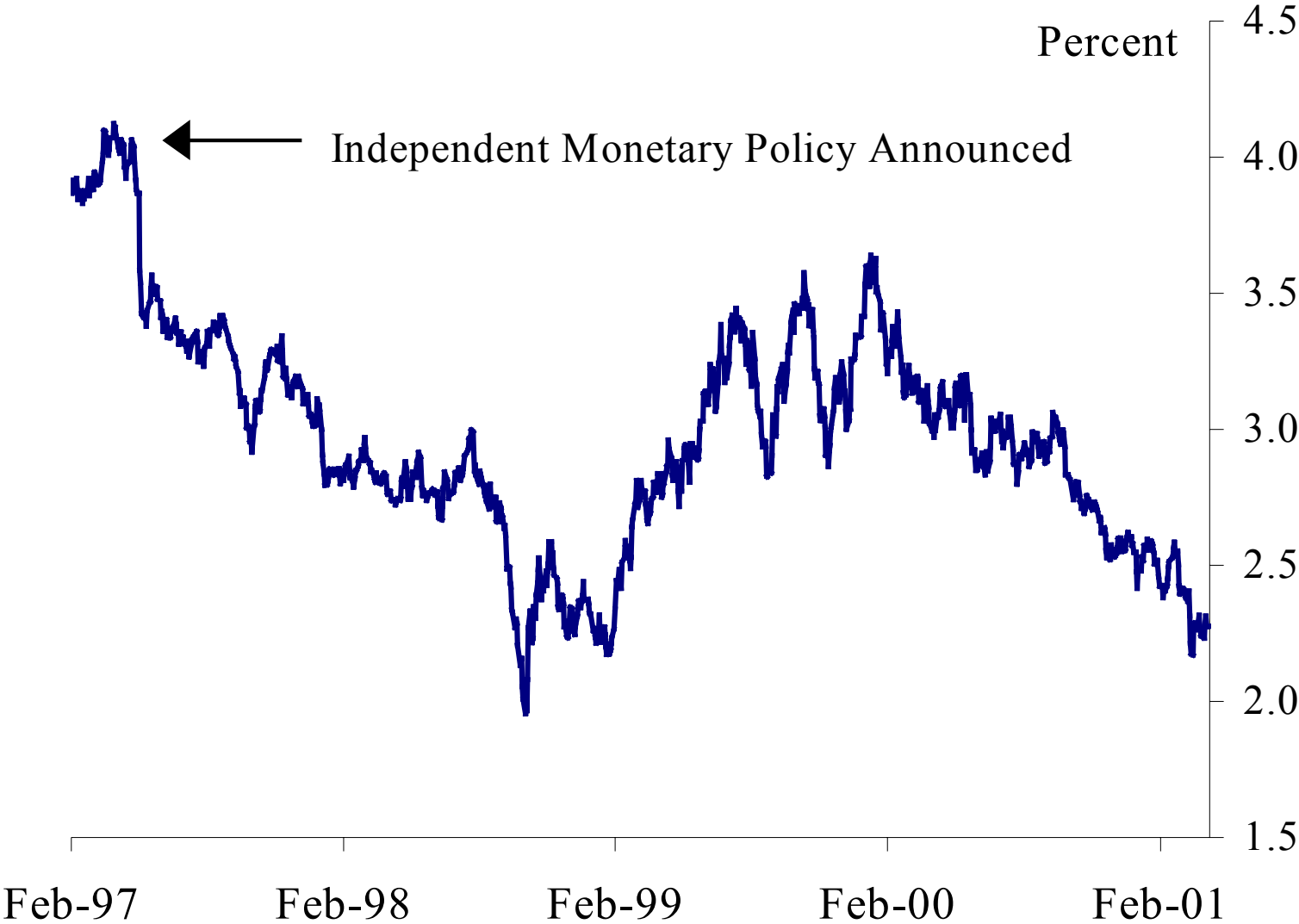
- 4th Anniversary of Operational Independence
- Nine member MPC
- “To maintain price stability, and subject to that, to support the economic policy of the Government”
- Chancellor’s remit - RPIX target of 2.5%

- Quarterly Inflation Report containing the MPC's inflation forecast
- Minutes now published after two weeks (previously six weeks)
- Individual accountability (publish votes)
- Appear before Parliament

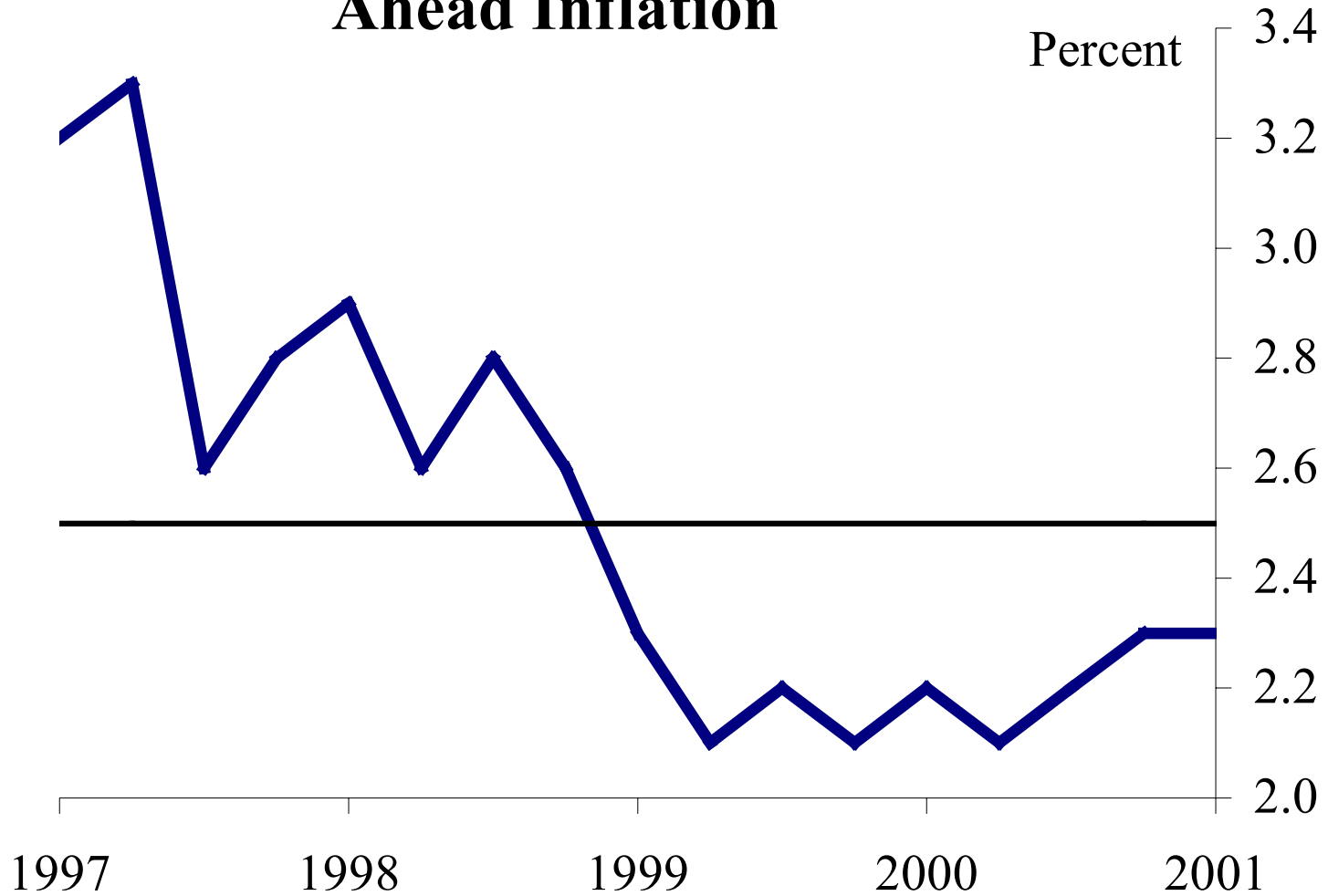
# RPIX Inflation



# UK Market 10-Year Inflation Expectation

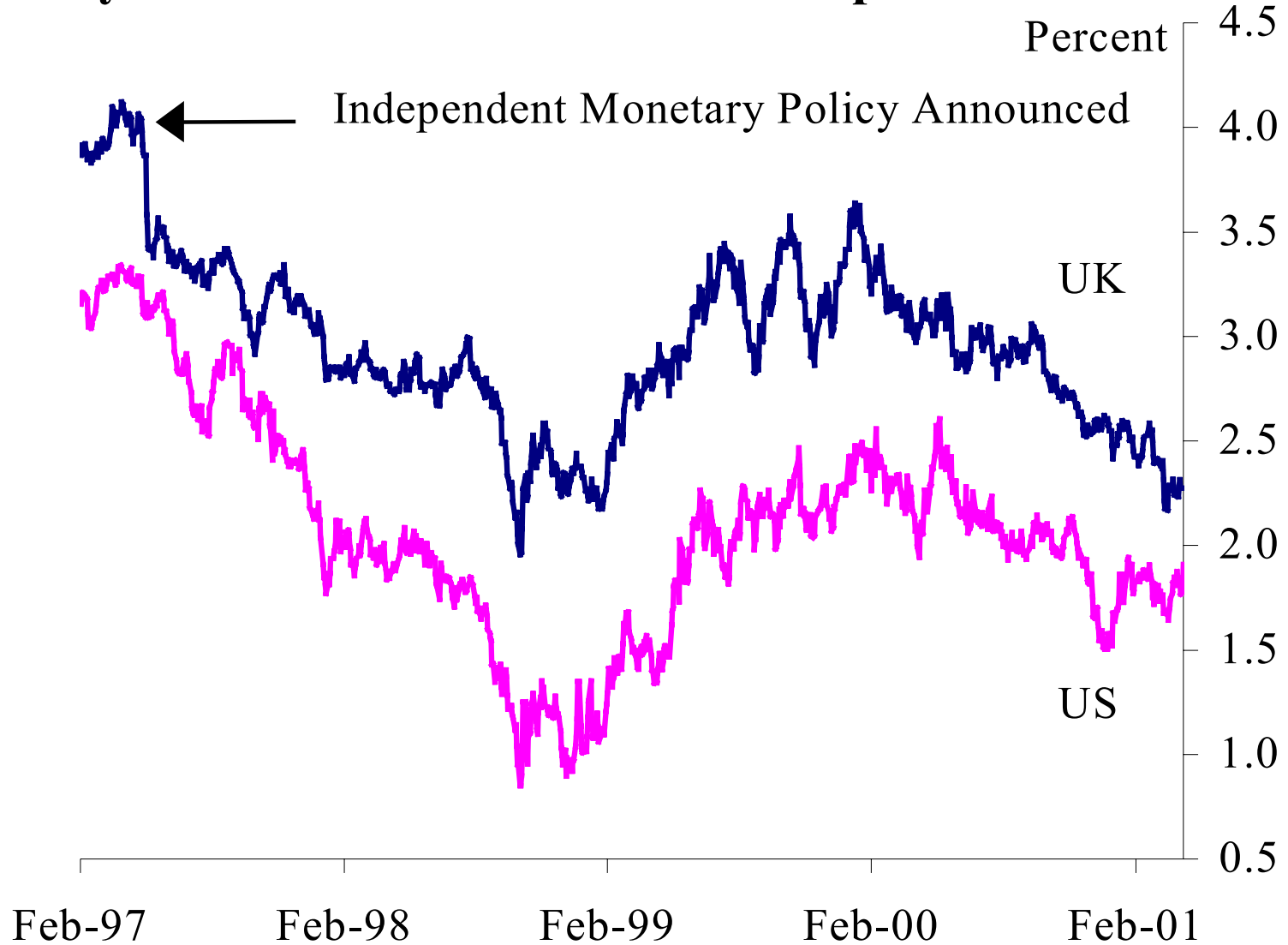


# Consensus Forecast of UK 4 Quarter Ahead Inflation

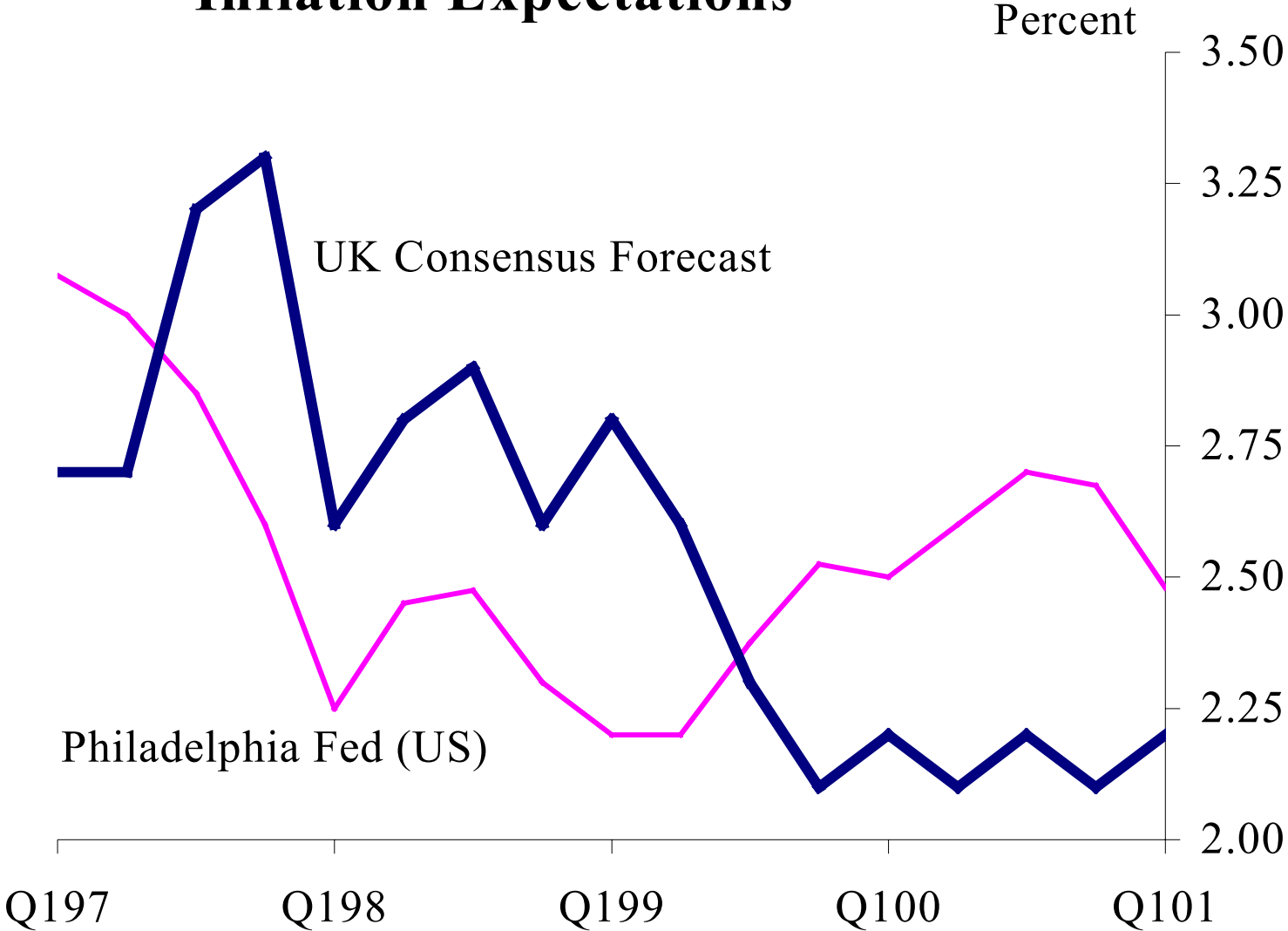


Source: Consensus Economics

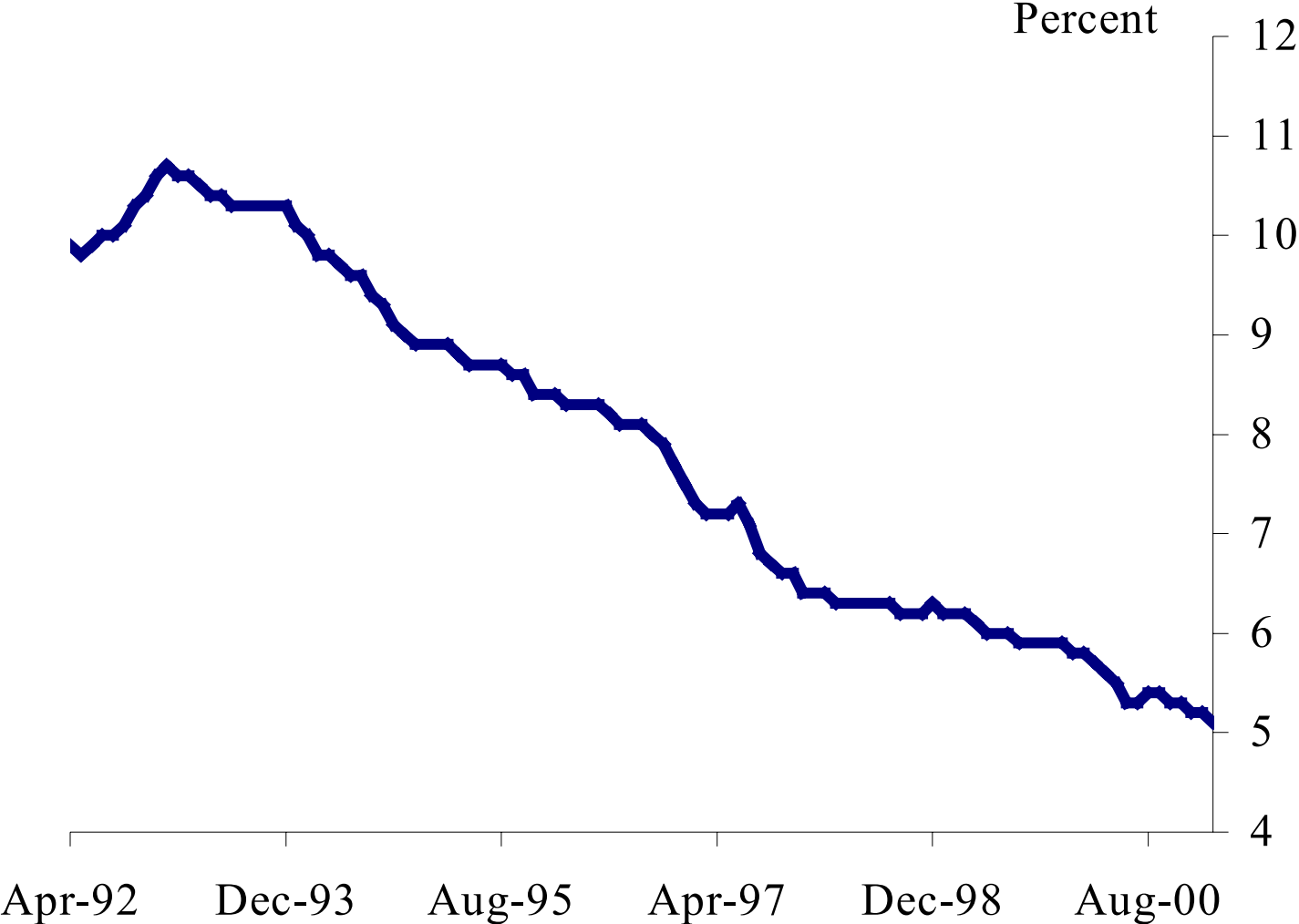
# Daily 10-Year Market Inflation Expectations



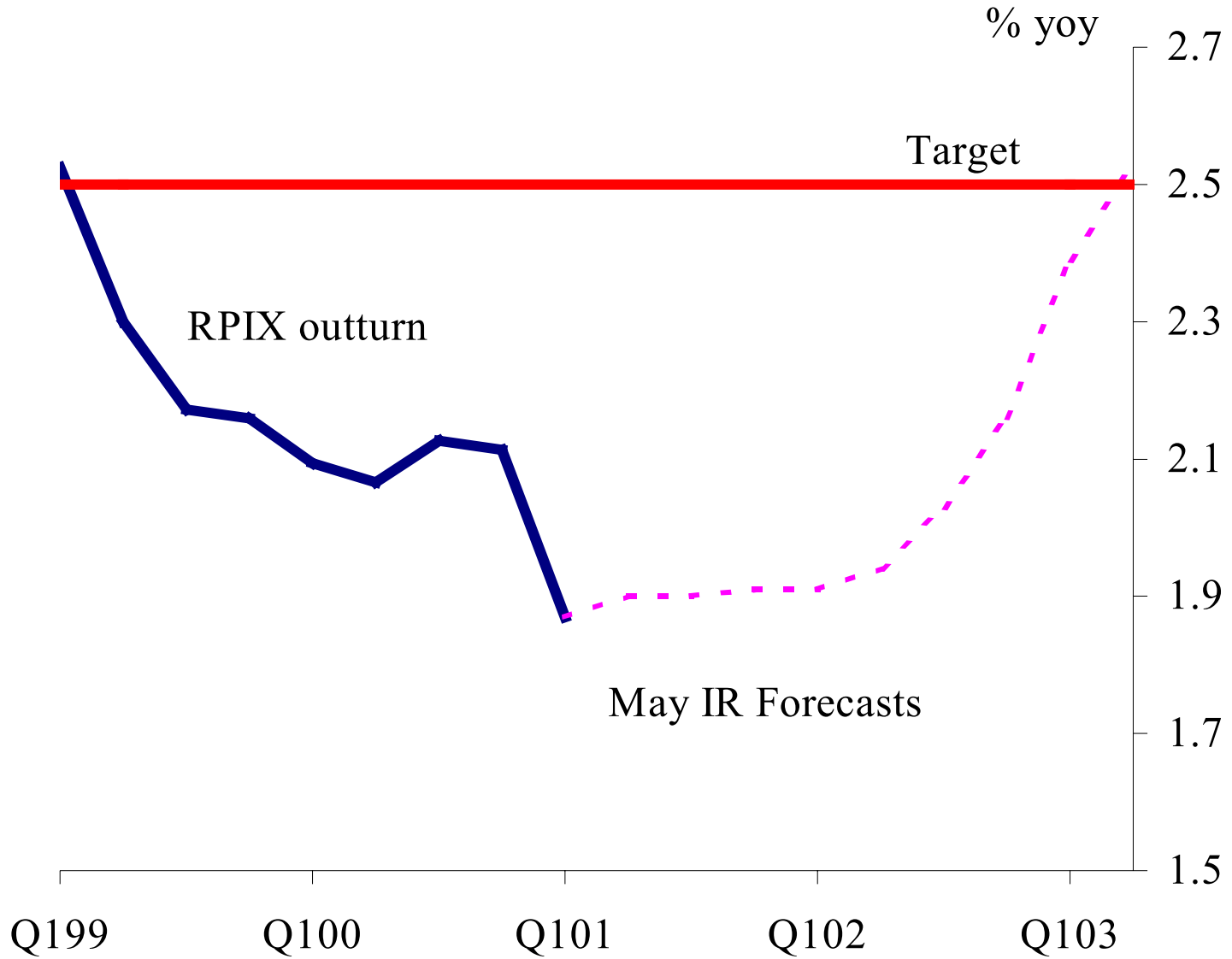
# Surveys of 1-Year Ahead US & UK Inflation Expectations



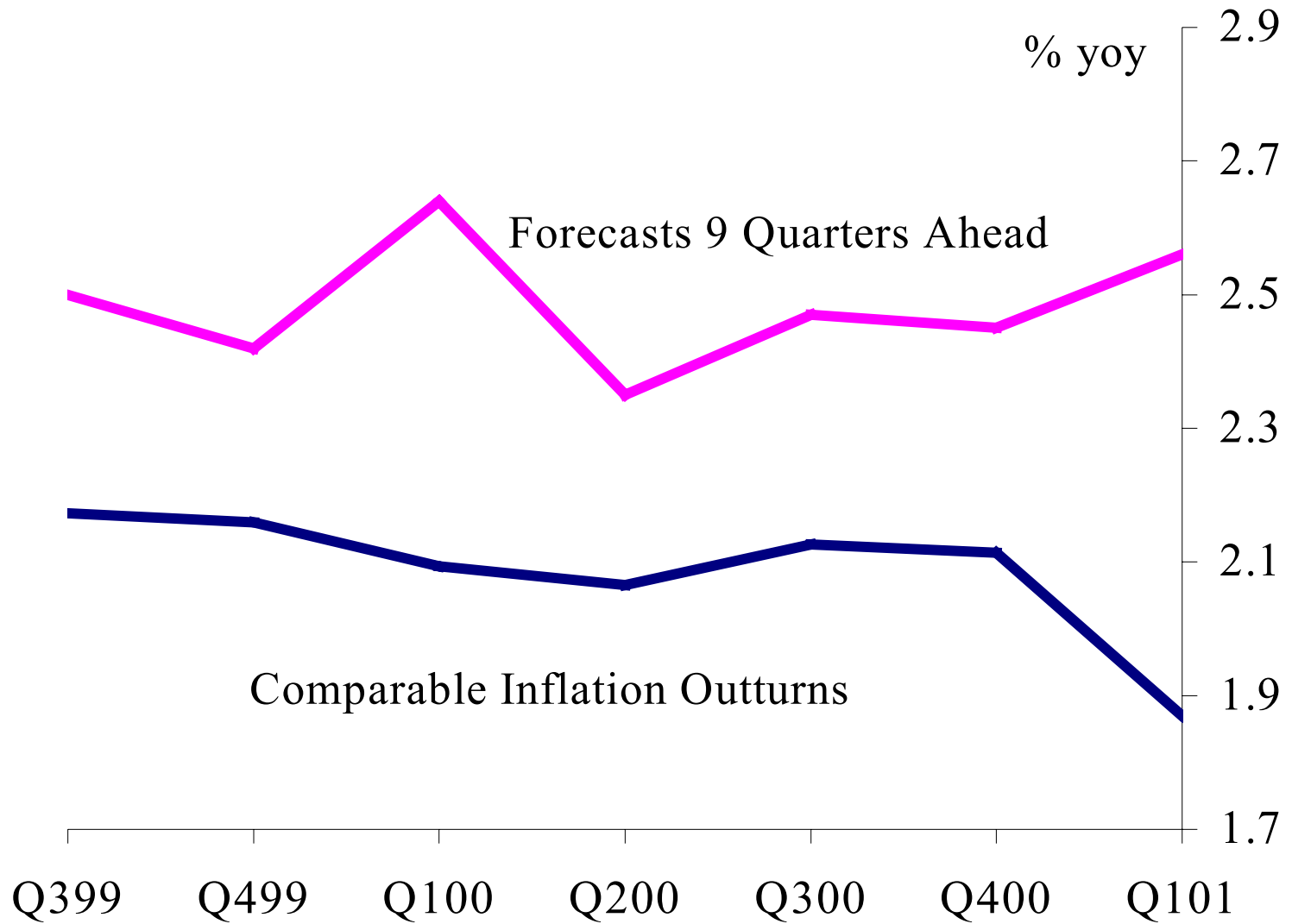
# LFS Unemployment



# RPIX forecast



# MPC Forecasts of Inflation vs Outturns



# Explanation for forecast errors

- Strong exchange rate
- ‘New Economy’

# Symmetry

- Critical part of the framework
- Permits highest level of growth that is consistent with the target

# Symmetry (cont.)

- TSC said “we are concerned that in an effort to establish credibility the MPC may have biased policy towards undershooting the target
- Have a symmetric approach
- Important to review changes in underlying economic relationships

# Transparency

- MPC minutes published in only two weeks
- Publish MPC inflation forecast every quarter
- Publish votes
- Culture allows dissent

**TABLE 2****AVERAGE CHANGE IN IMPLIED INTEREST RATES ON DAYS OF POLICY ANNOUNCEMENTS, 3 JUNE 1997 – 18 APRIL 2001**

COUNTRY	RATE	AVERAGE ABSOLUTE CHANGE (b.p.)	AVERAGE SCALED CHANGE <sup>1</sup>
UK	SHORT-STERLING	6.2	0.97
US	EURO-DOLLAR	3.4	0.67
EU-11 <sup>2</sup>	EURIBOR	3.3	0.85

1 Rescaled by implied market interest rates.

Using Bundesbank and DM data until 8<sup>th</sup> December 1999 and Euribor thereafter.

# Why is the BoE less predictable?

- Others offer greater ‘guidance’
- Individual accountability vs. consensus decision-making
- Learning curve

### TABLE 3

#### AVERAGE CHANGE IN IMPLIED INTEREST RATES ON DAYS OF POLICY ANNOUNCEMENTS 1997-99 VS 1999-2001

COUNTRY	AVERAGE ABSOLUTE CHANGE (b.p.)	
	1997-99 <sup>1</sup>	1999-2001 <sup>2</sup>
UK	8.3	4.1
US	1.6	5.0
EU-11	2.5	4.2

Notes: 1 3 June 1997- 12 May 1999

2 13 May 1999 – 18 April 2001

# Predictability - What next?

- Endeavour to explain our actions better
- Review link between individual forecasts and policy

# Conclusions

- Inflation expectations have come down to target, with unemployment continuing to fall
- Have undershot target for 2 years, expect to undershoot for nearly another 2 years
- Need to review forecasting processes

# Conclusions (cont.)

- BoE is more transparent, but not more predictable
- Predictability has improved in recent years
- Shall continue to endeavour to do better