House of Commons

Treasury Committee

Appointment of Spencer Dale to the Monetary Policy Committee of the Bank of England

Sixteenth Report of Session 2007–08

Volume II

Oral and written evidence

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The Treasury Committee

The Treasury Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of HM Treasury, HM Revenue & Customs and associated public bodies.

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Mr Graham Brady MP (*Conservative, Altrincham and Sale West)*
Mr Colin Breed MP (*Liberal Democrat, South East Cornwall*)
Jim Cousins MP (*Labour, Newcastle upon Tyne Central*)
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Mr Michael Fallon MP (*Conservative, Sevenoaks*) (Chairman, Sub-Committee)
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Witness

Wednesday 16 July 2008

List of written evidence

Oral evidence

Taken before the Treasury Committee

on Wednesday 16 July 2008

Members present

John McFall, in the Chair

Nick Ainger
Mr Graham Brady
Mr Colin Breed
Jim Cousins
Mr Philip Dunne
Mr Michael Fallon
Ms Sally Keeble
Mr Andrew Love
John Thurso
Mr Mark Todd
Sir Peter Viggers

Witness: **Mr Spencer Dale**, Executive Director for Monetary Analysis and Statistics and Chief Economist, Bank of England, gave evidence.

Q1 Chairman: Mr Dale, welcome to the Committee. Congratulations on your appointment. Can you introduce yourself for the shorthand writer, please?
Mr Dale: Yes. I am Spencer Dale, Executive Director for Monetary Analysis and Statistics at the Bank of England and the Bank's Chief Economist.

Q2 Chairman: You will be the last person appointed to the MPC without external advertisement. Do you think you would have got the job if you had faced an open application?
Mr Dale: I should start by saying I warmly welcome the change of the recruitment procedures for external appointments and I think it is only fit and proper for jobs of this nature. I think I am very well qualified for this job and so I do think I would have got the job.

Q3 Chairman: So you are a perfect fit?
Mr Dale: Yes, I hope so.

Q4 Chairman: You served as Mervyn King's Private Secretary when he was Deputy Governor, I believe, from 1997 to 1999. How will you demonstrate the independence of thought required for membership of the MPC and establish your own personality as opposed to the Governor's?
Mr Dale: For the people who know me from working inside the Bank I think I have already established that. I certainly feel that throughout my period, even working as the Governor's Private Secretary and more recently in my other jobs, I have demonstrated my independence of thought. The job I did prior to going to my two-year spell at the Board of Governors in the US was to lead the Bank's forecasting team. Your role as the head of the forecast team is essentially to challenge the judgments and assumptions the Committee is coming up with, challenge their suggestions, particularly if their judgments or assumptions conflict with the work of the staff and the analysis of the staff. That would then lead to very robust debates between the forecast team led by myself and the Committee, including the Governor. If you have any knowledge of the forecasting process of the Bank you will know that we spend many hours in with the forecast team discussing various technical issues and so I think I demonstrated my independence during that period. It is hard for me to judge how effective I was in that role but you could certainly ask any of the members of the Committee during my five years as head of the forecast team and they would certainly vouch for the nature of our discussions.

Q5 Chairman: So we could envisage you having a dust-up with the Governor?
Mr Dale: Yes.

Q6 Mr Fallon: If you are the ace forecaster how much importance do you attach to returning inflation to target sooner rather than later?
Mr Dale: The aim of the Committee is to bring inflation back in the medium term. The nature of our inflation target means that increases in prices today will stay in the annual rate of inflation as measured for a year, so it is quite possible for the Committee to raise interest rates very sharply in order to bring inflation very sharply back to target, but I think doing so would run the risk of creating undesirable volatility in output, so the aim of the Committee is to bring back inflation to target in the medium term.

Q7 Mr Fallon: We have seen some pretty wild swings in market expectations of interest rates in the first part of this year. Would you agree that a clearer signal of the Bank's strategy would cause less market turbulence?
Mr Dale: When thinking about the signal to the market about our strategy it depends on whether we are signalling what we are trying to achieve or the interest rate path which we think is going to achieve that. The Bank and the Committee (and as a member of the Committee I will continue to do so) will be very clear in our strategy of what we are trying to achieve, which at the moment is to manage the very big and conflicting risks to inflation on both sides in terms of the prospects for inflation. On the

one hand we have this sharp increase in inflation driven by an increase in the relative price of oil and commodity prices. We think because that reflects a change in relative prices rather than an increase in generalised inflationary pressures that will drop out of the calculation and inflation will return to target, but there is a risk that it may persist. On the other hand we see a slowing in the economy driven by the squeeze in real incomes and the tightening credit conditions, and there is a risk that the economy will slow so sharply that we will undershoot the inflation target. The Committee has been very clear in articulating its strategy of trying to balance these conflicting risks. It has been very clear in trying to say that it expects inflation in the near term to increase further away from the inflation target but that it expects that then to gradually fall away as these relative price effects dissipate and the economy slows.

The Committee suspended from 3.58 pm until 4.17 pm for a division in the House

Q8 Mr Fallon: Mr Dale, the Governor came in front of the Committee last month. I pressed him at some length on inflation expectations. How much do you think it matters that inflation expectations are now running so far away?
Mr Dale: It depends critically on the horizon of the inflation expectation. The Bank's own forecast as published in the May Inflation Report is that we expect inflation to rise in the near term as the impact of the oil and commodity prices feed through the supply chain into retail prices and then to fall away by the second year of the forecast and the third year of the forecast, so in some sense I think it is understandable and reasonable when survey measures of households' inflation expectations one year ahead have risen broadly in line with the Bank's own inflation forecast. What is far more worrying is if households' inflation expectations further out start to show signs of picking up.

Q9 Mr Fallon: But they are running away, are they not? Twelve months ahead people expect inflation to be higher than it is now.
Mr Dale: I think people's view of inflation over the next year is that inflation will pick up. The evidence that households' inflation expectations beyond one year have picked up is far less clear. We do not have very good survey data of households' inflation expectations further out but what measures we do have show far less signs of a pick-up and those survey measures of household expectations five to ten years out still look relatively flat.

Q10 Mr Fallon: What would be worrying would be if that increase in inflation expectations was based either on a growing lack of confidence in the inflation statistics themselves or in a public belief that you had simply lost control.
Mr Dale: If we start to see inflation expectations rise to a greater level than we think is warranted by our own inflation forecast I would agree with you, that would be worrying and that is in some sense part of the upside risk that the Committee and we are all concerned about when thinking about this balancing act. If inflation expectations remain firmly anchored as these relative price effects drop out of the calculation, we would expect inflation to fall back towards target, but if, as you suggest, the risk materialises that inflation expectations further out do pick up then that will cause inflation to remain above the target for a longer period of time and that is indeed the upside risk of the balancing act the Committee is trying to negotiate at the moment.

Q11 Mr Fallon: I ask this because in his first letter to the Chancellor a year and a bit ago the Governor said how important it was to anchor inflation expectations around 2%. You seem to have now slipped anchor.
Mr Dale: In terms of our measures of inflation expectations beyond the near term when these price level effects drop out there is far less evidence to suggest that inflation expectations have become unanchored.

Q12 John Thurso: Since you left university you have been at the Bank of England full time. Do you think that is an advantage or a disadvantage?
Mr Dale: I think it has advantages and disadvantages. I see my current job as Chief Economist as having two components to it. One component is being a member of the Monetary Policy Committee and I think to do that role I have to be an expert economist. You can become an expert economist working in the central bank surrounded by economists throughout your career or, likewise, you could have had an alternative career working either in business or in academia and have learned your economic skills in that way. The other aspect of my job is managing the monetary analysis and statistics area of the Bank, an area of 280-odd people, and making sure that we maximise their efficiency in terms of the briefing and the analysis they provide to the Committee. I have an advantage in a sense. I know that business. I have worked in that business for a long time. I know how it works. That business model is working well at the moment and so I do have an advantage in the sense that I think I know how to make a contribution in terms of making sure that the Committee continues to receive the high quality analysis it needs.

Q13 John Thurso: What are the three most valuable lessons that you took from your time at the Federal Reserve?
Mr Dale: Three?

Q14 John Thurso: Give me one.
Mr Dale: There are many. One is that one cannot think about processes in one system and impose them on another. In the Bank of England, for example, we, the staff, work with the Committee in a fairly intensive process to develop a forecast and so we spend many hours of meetings outside of the policy meeting where we discuss various judgments and assumptions, and I think that is a hugely valuable process. If you take it to the Federal Reserve system where the FOMC is far larger, 19

people spread around the whole of the USA, that system just is not possible and so you cannot just take one process and apply it to another. It has to be fitted within the structures you work in. Perhaps another thing which is a more practical thing I was struck by was that one of the pieces of briefing the staff would provide to the Federal Open Market Committee ahead of each meeting was some briefing which tried to say, "What are the best possible cases you could make for different interest rate decisions?", so not always but typically they would say, "What is the best possible case you could make for an interest rate cut, for an interest rate rise or for maintaining the current rate of interest rates?". I found that a useful piece of paper to put on the table because although the Committee here does think through those different options, the idea of putting on the table the best possible cases you could make for each one I think was quite a good disciplinary device to make sure all possibilities were considered. That was something which I think was a useful thing. I had not thought about it before I went to the Federal Reserve and it is something I will discuss with my colleagues on the Committee now I am back to see if they think something similar would be useful here.

Q15 John Thurso: You worked previously on the institutional design of the MPC, which of course has spent most of its operating time in quite benign conditions. How do you think it is coping in these more turbulent times?
Mr Dale: The institutional aspects of the Monetary Policy Committee seem to be bearing up well. I read in the Bank's annual report yesterday the report of the Non-Executive Directors and they said that the members of the Monetary Policy Committee were still happy and satisfied with the quality of the analysis they were getting, and in my discussions with the Committee members since I have been there it seems to me that they are very satisfied with the processes in terms of the type of analysis they are getting and the opportunities they have to discuss the key economic issues. That is not the challenge the Committee faces. The challenge the Committee faces is just that the economic shocks that the UK economy is currently suffering are very difficult. That is the challenging environment, not the underlying processes.

Q16 Mr Dunne: I think you were responsible for managing the introduction of the BEQM quarterly model at the Bank. How is it working in these more turbulent times?
Mr Dale: I think it is working well. The important thing is that one has to be careful what one asks models to do. All models in some sense are wrong; they are abstractions from reality and when used correctly they are a way of helping one think through economic issues and problems. They are not something where you just turn a machine on and believe the answer. Some models will be good for answering some problems and not for others. BEQM, for example, like most macroeconomic forecasting models, does not have a well developed financial sector. It does not have lots of different financial assets with lots of different financial spreads. One of the big issues we face at the moment is trying to map how changes in financial conditions affect the macro economy. I do not think BEQM is well suited to that and I think the Committee recognises that, but a key feature of the forecasting structure and process of the Bank is that the Bank uses a suite of models. It does not just use one model; it uses a whole host of models, so in some sense the key thing to recognise with a model like BEQM is how not to use it as well as how to use it, and so I think it is working in some aspects well now and in other aspects the Bank, the staff and the Committee are having to rely on other types of models.

Q17 Mr Dunne: In taking up this new job are there any things that you would like to do to ensure that you are as well equipped for it as possible, such as talking to other chief economists in other central banks around the world or have any specific training, have a talk-in from the Sage of Omaha or someone? Is there anything specific you are doing?
Mr Dale: Before coming in front of the Committee today I thought the best training I needed was how to speak to a committee of MPs. I have quite good contacts with economists in other central banks already. I have obviously just spent two years at the Federal Reserve Board. Prior to leaving I had good contacts with the ECB and I hope to maintain those. I also before leaving had good contacts with many City economists and with many people in academia and I hope to rebuild those. One thing I hope to be able to do more than I did before is go out in terms of meeting business contacts in the real economy rather than people just working in the financial sector. I used to do that quite a bit in my previous job and I think the onus now, being a member of the Monetary Policy Committee, having to explain my decisions and the Committee's view as a whole, means I should do more of that and I welcome that opportunity and I will work with the Bank's regional agents to try and travel more around the country.

Q18 Sir Peter Viggers: What were the main differences between the attitude and actions of the Fed, the European Central Bank and the Bank of England in relation to the recent liquidity difficulties?
Mr Dale: I was obviously only involved directly in one of those central banks at the time, which was the Federal Reserve Board, and was not intimately involved in what was happening at the Bank or the ECB, so I could only observe from the outside. My impression is that there was not a significant difference in the objectives of what people were trying to achieve, which was trying to inject sufficient liquidity to ensure that the banks could get through the temporary problems, and the apparent difference between the central banks seemed to me to be to do with the nature of the operating systems in the central banks rather than some fundamental difference in what the central banks were trying to achieve.

Q19 Sir Peter Viggers: And have there been lessons learned over the last couple of years as to the way you would treat future difficulties?
Mr Dale: Yes, undeniably so. It would be a sad state if we had not. The Bank, as you well know, is reviewing its Red Book to think about how it should think about the structure of its monetary policy operations, in particular to make sure it has an operating system which works well in both good times and times of stress. The Federal Reserve will also recognise that it is relatively easy to design a system which works well in good times. It is trying to think of a system which is also robust in times of tension which is the challenge, and the challenge which I think has been highlighted by the episodes of the last year.

Q20 Jim Cousins: Mr Dale, do you think that the Monetary Policy Committee is at the present time providing any real strategic leadership for what the actual mortgage rates that people are paying are?
Mr Dale: The job of the Monetary Policy Committee is to set a level of Bank Rate which it thinks is appropriate to achieve the inflation target. I think the relationship between that Bank Rate and the mortgage rates faced by households has changed as banks are trying to rebalance their balance sheets and undergo their own adjustments, and I think that is only right and proper. I think what the Monetary Policy Committee will be doing is trying to set the appropriate level of Bank Rate and if the relationship between the Bank Rate and the mortgage rate changes then it will need to reflect that in its own decisions.

Q21 Jim Cousins: What does that mean?
Mr Dale: What it means is that I do not think it is the job of the Monetary Policy Committee to provide strategic advice to banks about how they should price their individual mortgages. I think it is the role of the Bank of England to set the level of interest rate it thinks is appropriate to hit the inflation target.

Q22 Jim Cousins: Through its market operations making additional liquidity available the Bank does not seem to be affecting the availability of mortgages, and indeed, as I understand it, has actually said that it does not necessarily want to influence the availability of mortgages.
Mr Dale: The Bank's liquidity operations are designed to rebuild confidence in the banking system and facilitate the process of the restructuring of banks' balance sheets and the de-leveraging that banks are going through at the moment. That is what it is designed to do. It is not designed to promote particular forms of lending, be it to households or to corporates.

Q23 Jim Cousins: Mr Dale, you have just come back from the United States where a problem in the housing market is gradually swallowing greater areas of the economy and dragging them into difficulty, and in the United States, of course, they have a number of institutions to affect the working of the housing market that we do not have here, and yet against the background of that experience you come back here and tell us that it is not the role of the Bank to seek to influence the actual level of mortgage rates, nor to worry if there is a disconnect between the level of bank rate being set and mortgage rates, and not to worry about whether its liquidity operations are affecting the availability of mortgages, so what is the point of you?
Mr Dale: The point of us is not to try to stimulate or provide safety nets to particular parts of the economy. We have a very simple objective, which is to try and achieve the inflation target over the medium term, and I think if we start to try and achieve objectives other than that we will lose sight of our primary goal which has been given to us by Parliament and by Government, which is to achieve the inflation target.

Q24 Jim Cousins: So as these problems gradually work through our own economy, through the housing market, which plainly now is beginning to happen, your view of the role of the Bank of England is that it should stand behind a tree and talk about something entirely different?
Mr Dale: No, I do not think that at all. As I said in a previous answer, I think one of the important shocks that we are trying to respond to at the moment is the slowing in the economy associated with the tightening credit conditions. An important dynamic of how those tightening credit conditions affect the real economy is via the housing market, and so I agree with you: we do see the housing market starting to slow, we see house prices falling since the autumn of last year, we see housing market activity also falling. If we think that the adjustment in the housing market is going to cause output to slow to an extent which will lead to a very pronounced outturn in the economy which will threaten the medium term attainment of the inflation target, then I think it will be appropriate for the Monetary Policy Committee to respond to that. But those developments in the housing market have to be seen in the context of the implications they have for the macro economy and for the attainment of the inflation target.

Q25 Jim Cousins: So you have just come back from the United States where the central bank there is trying—even if it is not succeeding it is trying—to get ahead of events and you have come back to tell this Committee that you are absolutely content and you think it is absolutely right that our central bank should run behind events?
Mr Dale: Obviously, I do not think it is appropriate for me to comment on Federal Reserve policy. What I was trying to tell the Committee was that I think it is absolutely right that the Monetary Policy Committee remains focused on the goal it was given by Government, which is to achieve the inflation target over the medium term.
Chairman: Any other comments?

Q26 Nick Ainger: Just following on from Mr Cousins' questions, are you particularly concerned that in this time of financial turmoil and global prices forcing up inflation in this country literally the only tool in the MPC's toolkit is interest rates which do not seem to have any effect whatsoever on the current situation?
Mr Dale: I have two responses to that. One is, I do not think I would accept the idea that somehow the potency of monetary policy has changed; I think our ability to control the economy has not changed. I accept the idea that the relationship between Bank Rate and other rates in the economy has changed but I do not think that affects the potency of policy.

Q27 Nick Ainger: When do you expect that to return to what it was a year, 18 months, ago when there clearly was an impact, that when you raised or lowered interest rates there was a response out there in the economy?
Mr Dale: I still think there is a response. I just think when there are many other shocks going on it is very hard to run the counter-factual to see how interest rates would have been if Bank Rate had changed in some other way. The other point I was going to say is that although we have only one instrument, interest rates, the other really important quasi-instrument the Monetary Policy Committee has is its communications. Throughout the new monetary framework and since the inception of the Monetary Policy Committee we have emphasised the importance of openness and transparency but in the period now, when we are faced with a world of increasing inflation and inflation above target and slowing growth, I think it is even more important for the Committee to explain as clearly as possible its view of the economic outlook and how that is consistent with achieving its economic objectives.

Q28 Nick Ainger: The current rate is 3.8% on the CPI, but people out there, particularly those who may be in the lowest quartile of earnings, laugh at that figure when all their income is going on rising energy costs, the price of fuel at the pump, rising food prices and in many cases even higher mortgage rates as well particularly if their two-year deal has just come to an end. The *Daily Mirror* says that inflation for those people is running at over 18%. Should you be challenging that sort of information because clearly people when negotiating wages and so on look at their own circumstances, not at some figure which has come out of the Bank of England which they just do not believe any more?
Mr Dale: For clarification, obviously the Bank of England does not calculate the inflation numbers, they are calculated by the Office for National Statistics. There is no uniquely right measure of inflation. The relevant measure of inflation will depend on the mix of goods and services an individual household buys and so for some households who spend a disproportionate amount of their income on energy and food their rates of inflation may well be higher than the average CPI, but the CPI is designed to be representative of the household sector as a whole, so although for some people their inflation rates may be higher, for other ones their inflation rates may be lower because those households are spending money on food and energy but are also buying clothes for their children or new shoes and those prices are actually falling over this period. So it is certainly the case if one picks a set of goods which have been rising very rapidly one can say, "That is what I spend my money on, those inflation rates are high", but the CPI is designed to be a representative basket of the goods purchased by the household sector.

Q29 Mr Love: In a sense this question follows on from that because there has been a lot of inflation expectations, and while I accept what you say in order not to disrupt the economy more than normal it is sensible to keep interest rates at their present level, we know, regardless of what the *Daily Mail* or the *Mirror* say about the 19%, expectations out there amongst the public are rising, and are rising quite fast. What can the Bank do to address that issue about the rising expectation amongst the public of inflation and therefore maybe an attempt through second order effects that will inevitably make the inflationary pressures even worse?
Mr Dale: The risk that inflation expectations pick up as a result of what we think will be a temporary increase in inflation, and that somehow that will lead to an increase in inflation expectations further out and a persistent increase in inflation, is a very real risk and is the other half of the risk the Committee is trying to balance off. All the Committee can do is to remain firmly committed and to keep demonstrating its firm commitment that it will take whatever actions it needs to take in order to hit the inflation target.
Mr Love: But if you are not listening to those silent voices out there amongst the right wing press which tell you to put up interest rates, which I congratulate you for not doing, what are you doing to address the issue of those expectations that people have, many of which are not an accurate reflection even of the inflation rate they expect? Is there more that the Bank and its organisations can do to get the message across about what the reality is?

Q30 Chairman: For the public record, we have not been informed as to how you voted so the congratulations could be premature!
Mr Dale: I am afraid I am going to have to repeat the answer I gave before. This puts the premium on the Bank to explain—

Q31 Chairman: We have understood your answer, Mr Dale. You welcomed our recommendation that the MPC should strengthen contacts with professional economists working outside the Bank and signalled your desire to do so as chief economist. Quickly, how are you going to do that?
Mr Dale: The Bank has been actively exploring the possibility of setting up some sort of conference or workshop with external economists and has been in liaison with City economists and academics as to exactly what form that can take, and our intention at the moment is we will hold our first one of those

sometime later this year. The precise details we have not yet worked out and I do not want to take any credit for this because this was all before I came but that is the concrete step we plan to take.

Chairman: Perhaps an even briefer answer, when is this economic downturn going to finish?

Q32 Mr Love: Precise date please!

Mr Dale: That I am afraid I do not know.

Q33 Chairman: Okay. Thank you very much for your time and we wish you every success in your new post.

Mr Dale: Thank you very much.

Written evidence

Treasury Committee Questionnaire: Response from Mr Spencer Dale

Responsibilities as a Member of the Monetary Policy Committee

1. *Please explain how your experience to date has equipped you to fulfil your responsibilities as a member of the Monetary Policy Committee*

I have worked as an economist at the Bank of England since 1989 and have worked closely with the Monetary Policy Committee (MPC) since its inception in 1997. I have considerable experience of analysing the UK economy and of providing advice to the MPC on the economic outlook and on the policy issues faced by the Committee. I have led work programs at the Bank on a range of economic issues, including on the implementation of inflation targeting and on the design and construction of the Bank's macroeconomic forecasting model. I have published numerous research articles on central banking issues, including on central bank communications and on monetary policy strategy. My work at the Bank has also allowed me to develop extensive contacts with City and academic economists, business organisations, and other central banks. Most recently, I spent the past two years working as a Senior Adviser at the Board of Governors of the Federal Reserve System, where I had the opportunity to observe and contribute to the work of the Federal Open Market Committee (FOMC), including attending FOMC policy meetings. I believe that my extensive experience both as a professional economist and as a central banker should stand me in good stead to fulfil my responsibilities as a member of the MPC and as the Bank's Chief Economist.

2. *What contributions have you made individually to the conduct of monetary policy within the Bank?*

I have been working as a senior economist at the Bank of England since the UK first adopted an inflation target in 1992 and have contributed in a number of ways to the understanding, implementation, and communication of the current monetary framework. Between 2000 and 2006, I was responsible for advising the MPC on current developments in the UK economy and for overseeing the production of the Committee's quarterly inflation projections, which are published in the Bank of England's Inflation Report. In this role, I provided regular analysis and advice to the Committee on the key issues affecting their policy decisions and, with regard to the quarterly forecast, helped to produce one of the most important outputs of the Committee, both in terms of the Committee's policy decisions and its communications strategy. Prior to that, I was responsible for advising the MPC on developments in UK monetary and financial conditions and for leading the Bank's work on the implementation and operation of the new monetary Framework. When the MPC was first created in 1997, I was part of a small group of Bank officials tasked with designing and implementing the structures and processes used to support the MPC.

3. *What activities do you intend undertaking in order to add to the public's understanding of the role and decisions of the Monetary Policy Committee?*

I believe strongly that the effectiveness of UK monetary policy depends on the financial markets and wider public having a good understanding of the aims and objectives of the MPC and of the factors affecting its decisions. As Chief Economist, I expect to play an important role in the preparation of the key documents through which the Committee communicates with the public, most notably the quarterly Inflation Report. As with my colleagues on the MPC, I also expect to make regular speeches explaining my views on the current issues and challenges facing UK monetary policy, and to hold meetings with business contacts and other organisations throughout the country via the Bank's network of regional Agents.

4. *Do you intend to serve out the full term for which you are appointed?*

Yes.

Responsibilities as Chief Economist

5. *Please explain how your experience to date has equipped you to fulfil your responsibilities as Chief Economist of the Bank of England. In particular, in what areas do you believe you will be able to make an immediate contribution and in which areas will you have to undertake additional research when in post?*

Apart from the two years I recently spent at the Board of Governors of the Federal Reserve System, I have worked at the Bank of England continuously since 1989. Almost all of that time has been spent working in the Monetary Analysis area of the Bank. As such, I have considerable experience and knowledge of the issues and subject matter covered by the economists working within that area and of the key channels and processes through which Bank economists provide briefing and advice to the MPC. I have also worked closely with the Bank's regional Agents who provide an important source of information to the Committee. Consequently, I expect to be able to make an immediate contribution to much of the work of Monetary Analysis. As Executive Director for Monetary Analysis and Statistics, I also have responsibility for the Monetary and Financial Statistics area of the Bank and for the Bank's Centre for Central Banking Studies. I have had less direct experience of these areas and expect to spend some time over the next few months becoming better acquainted with them.

6. *What are your major objectives for the first six months as Chief Economist?*

As you are aware, the MPC is facing its most challenging economic environment since its inception, stemming from the combined impact of the continuing dislocation of financial markets and the associated tightening of credit conditions and the substantial increase in energy and import prices. My primary focus as Chief Economist over the next six months will be to ensure that the briefing and analysis received by the Committee continues to be of the highest quality and addresses all the issues necessary for the Committee to make informed policy decisions. A particularly important issue in that regard will be to continue to contribute to the Committee's understanding of the factors underlying the increase in energy and other commodity prices and of the appropriate response of monetary policy to these relative price shocks. The challenges currently facing the Committee mean that it is vitally important for the openness and transparency of the monetary policy framework to be maintained and for the MPC to explain clearly its view of the economic outlook and the reasons for its decisions. As Chief Economist, I hope to play a major role in this communication process, both in terms of explaining the views of the Committee as a whole and in describing my own views.

7. *As Chief Economist, what will be your research priorities for the next three years?*

The Bank's research priorities for the Monetary Analysis area are discussed and agreed collectively by the MPC. Some of the existing priorities relate to areas of perennial interest to the Committee, such as improving the Bank's understanding of the changing nature of the monetary policy transmission mechanism in light of the evolving economic and financial landscape. Other priorities relate more directly to some of the key issues currently facing the Committee, such as better understanding the determination of inflation expectations and the price-setting behaviour of firms. These priorities will inevitably need to be reviewed and adjusted as the economic environment develops. An area of particular personal interest to me in the past has been improving the design of central bank communications and I hope to continue to contribute to the Bank's research in this area.

8. *As Chief Economist, how will you ensure that the research undertaken by the Bank is of relevance to a wide audience, including both City economists, and the public?*

As indicated in the answer to question (7), the research undertaken at the Bank is driven by the policy issues facing the MPC and the value of the research is judged according to the contribution it makes to the policy process, rather than solely on its technical merit. In addition to the Bank's Working Paper series which reports the more detailed aspects of the Bank's research, the broader policy relevance of the research is often described in the Inflation Report and in articles in the Bank's Quarterly Bulletin. Speeches by MPC members also often draw extensively upon research by Bank economists. As Chief Economist, I will continue to support and encourage the dissemination of Bank research to a wider audience. I am also keenly aware that the Committee has much to learn from understanding and applying the work of economists outside of the Bank, both in the City and in academia. I very much support the suggestion made previously by the Treasury Committee that the MPC should strengthen its contacts with professional economists working outside the Bank, and I intend to work with the rest of the MPC to take further steps in this direction.

Macroeconomics

9. *Over the next three years, what are the major risks you foresee to the MPC meeting the inflation target?*

I expect the pass-through from the recent increases in food and energy prices to cause CPI inflation to move substantially higher over the course of this year, before gradually falling back to around the target as these relative price effects dissipate and the economy slows. But there are considerable uncertainties surrounding this profile. To the upside, there is a possibility that food and energy prices may continue to increase rapidly and cause CPI inflation to persist above the Committee's inflation target. This upside risk to inflation is compounded by the possibility that a sustained period of above-target inflation may become embedded in wage and pricing decisions and so increase the persistence of the inflationary shock. The possibility that the public's longer-term inflation expectations may begin to drift upwards is a key risk affecting the inflation outlook and the efficient functioning of the economy more generally. To the downside, the tightening in credit conditions and the squeeze on real incomes stemming from the increase in energy prices is likely to cause demand growth to slow further. There is a risk, especially if financial conditions were to tighten more, that output could slow to the point that the resulting slack in product and labour markets caused inflation to fall to below its target. The difficulty of balancing these substantial opposing risks to the inflation outlook represents the key challenge facing the MPC in the current environment.

10. *How important do you think the official measures of inflation are in the wage-setting process in the United Kingdom? As Chief Economist, do you intend to conduct further work into inflation expectations and wage-setting?*

Official measures of inflation undoubtedly play an important role in the wage-bargaining process. However, even in organisations in which pay settlements are linked directly to an official measure of inflation, such as the Retail Price Index, overall earnings growth in that organisation is likely to depend on a range of other factors. These include the rate of underlying productivity growth, the rate at which the organisation's non-wage costs are increasing, the tightness of the labour market and so on. In the context of the current economic environment, the increase in firms' non-wage costs stemming from the rise in oil and other commodity prices, combined with the moderation in labour demand associated with the slowing in economic growth, should help to dampen the upward pressure on nominal wage growth exerted from the current period of above target rates of inflation. However, the possibility that employees might resist the reduction in their real income growth stemming from the higher cost of food and energy by raising wage demands represents an important risk to the inflation outlook. The intelligence gathered from the Bank's network of regional Agencies will be especially important in monitoring this risk.

As noted in the answer to question (7), improving the Bank's understanding of the determination of inflation expectations is one of the Bank's key research priorities. Bank economists also have an ongoing programme of work on wage and price dynamics, including working with colleagues in other central banks exploring issues relating to wage dynamics. A number of articles have been published in the Quarterly Bulletin and in the Bank's working paper series in recent years on wage and price setting, including on the macroeconomic effects and characteristics of immigration, and on developments in wage flexibility.

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