Interest rates might have to rise further to tackle soaring inflation says Bank of England chief economist

The Bank of England’s chief economist, Huw Pill, has suggested that interest rate rises could have further to run in the fight against soaring inflation.

Speaking at an ACCA breakfast event in Cardiff, Mr Pill said with inflation now running at 9%, and forecast to soon hit double-digits, as a rate setting member of the bank’s Monetary Policy Committee he was conscious of its disproportionate impact on the least well off, while describing it as the “biggest challenge the MPC has faced over the past quarter of a century.”

On the current rate of inflation and the bank’s set target of 2%, Welshman Mr Pill said: “For a monetary policy maker charged with achieving an inflation target of 2%, this is obviously a very uncomfortable situation.

“But, of course, my discomfort as an MPC member in these circumstances is as nothing to the challenges facing those most directly exposed to the current cost of living crisis. These are difficult times for many people, especially for the less well off, who spend a higher proportion of their income on energy and food, where recent price rises have been most significant.

“Current challenges are thus a salutary reminder of the importance of price stability as an anchor for wider economic stability, and a bulwark to sustaining people’s livelihoods, especially for those on lower pay and fixed incomes. Acting to achieve the MPC’s 2% inflation target is therefore now more important than ever."

At this month's MPC rate setting meeting Mr Pill voted in favour of the agreed increase in the base rate from 0.75% to 1%. He signalled that further rises could be needed to cool inflation.

Mr Pill added: "It is in these testing times that the anchor represented by the 2% inflation target comes to the fore. Supported by the independence accorded to the MPC to pursue that target, we are able to take the sometimes tough decisions to bring inflation back to 2% and keep it there sustainably.

"It is that commitment that has led me to support a tightening of monetary policy since I joined the committee last September, and to signal today that this tightening still has further to run."

He said the new Covid wave in China and Russia's invasion of Ukraine had "exacerbated supply disruptions, prolonging the inflationary impulse."

He added: "Rises in international goods and energy prices pose a particular challenge to UK monetary policy. Not only do they exert a strong direct influence over inflation but – since the UK is a net importer of food, energy and goods – they also imply a squeeze on the real incomes of UK households. Simply put, the price of what the UK is selling has fallen relative to what the UK is buying, leaving UK residents worse off.

"So the MPC forecasts that, as we move towards the end of this year, this real income squeeze coming from higher international energy and goods prices will slow domestic demand and eventually result in higher unemployment and a looser labour market. That loosening does much to cool the domestically generated wage, cost and price pressures on which the MPC is rightly focused. It is this component of inflation over which UK monetary policy exerts greatest influence.

“Just as the main reason the MPC forecasts headline inflation to rise to double digit levels at the end of this year is the impact of higher international energy and goods prices over which it exhibits little influence, the main reason the MPC projects headline inflation to fall sharply in 2023-24 back towards the 2% target is its assumption that those international energy and goods prices stabilise or fall six months from now.”

However, he added: “Of course, such assumptions may be wrong. We’ve seen that in the past.”

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