Inflation-busting public sector pay rises risk stoking inflation, Bank of England governor warns

The governor of the Bank of England has told MPs that its forecasts for inflation to more than halve this year are at risk from price and wage-setting as unions continue to demand large public sector settlements.

Andrew Bailey was speaking after the Bank **raised its base level of interest rates** to 4% from 3.5% last week as it judged that while inflationary pressures were generally easing, there were stubborn elements still unclear and at play.

At that time, the monetary policy committee was split on whether to raise rates at all but the voting opted for the 0.5 percentage point hike given that the main measure of inflation remained in double digits at 40-year highs.

“We are concerned about persistence [of inflation] and that’s why, frankly, we raised interest rates this time,” he told the Treasury select committee.

“I am very uncertain, particularly about price-setting and wage-setting in this country. We have got the largest upside skew in our forecasts that we have ever had on inflation.”

The Bank is forecasting that the Consumer Price Index (CPI) will fall to around 4% by the end of the year – from its current level of 10.5% – but that is based on a lack of additional shocks for the UK and wider global economy.

The index tracks inflation by monitoring the price of an average basket of consumer goods.

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Last week: BoE governor explains interest rate rise

The war in Ukraine exacerbated rising costs witnessed since the end of the pandemic – with energy prices hitting record levels and being passed on down supply chains, through to consumers and businesses.

As wholesale energy and commodity costs ease, the Bank sees hope that the hit to the economy will ease too.

Its 10 consecutive rises in its base level of interest rates have been aimed at deterring, what it calls, secondary inflation.

The theory goes that if you make borrowing costs more expensive, activity in the economy is dented and things like wage rises are depressed to stop pressure on inflation being intensified by high spending.

Private sector wage growth has exceeded that of the public sector substantially since the COVID crisis struck and many unions are seeking inflation-busting pay rises to make up for lost increases and help their members navigate the squeeze on their budgets.

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Strikes have hit the likes of the NHS and railways amid a failure to bridge the gulf between the demands of the unions and what ministers argue is affordable.

Mr Bailey said that the Bank's forecasts for inflation could be placed at risk if, on paper, the government was to fund any large pay rises through public borrowing rather than tax increases.

"What I would urge is that – particularly going forwards because we think inflation is going to fall very rapidly – that is taken into account," he said, explaining that he was speaking in economic and not political terms.

"We've seen pay settlements, in particular in the private sector, are higher than consistent with the target, but not at the level of inflation."