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BUSINESS NEWS

11 DE FEBRERO DE 2009 / 4:11 AM / UPDATED HACE 12 AÑOS

King's statement on Bank Inflation Report

By Reuters Staff



(Reuters) - Following is the text of a statement by Bank of England Governor Mervyn King on the bank's quarterly Inflation Report on Wednesday.

INFLATION REPORT PRESS CONFERENCE

Wednesday 11 February 2009

Opening Remarks by the Governor

The UK economy is in a deep recession. Monetary, fiscal and financial policy have all responded vigorously to that prospect. But the length and depth of the recession will depend to a significant extent on developments in the rest of the world, where a severe economic downturn has taken hold. Growth in the advanced and emerging market economies fell sharply towards the end of last year. And world trade is contracting rapidly.

As in the UK, the scale and synchronised nature of the downturn around the world has been driven by two factors a further tightening of credit conditions following failures in the international banking system, which means that lending, especially to companies, is still slowing, and a collapse of confidence, or "animal spirits" in Keynes' description, that is leading to falls in spending and production. Restoring both lending and confidence will not be easy and will take time.

In many countries, governments have now taken significant measures to improve conditions in financial markets and support lending. Three weeks ago, the UK Government announced a five-

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the measures are in place, it will take time for banking and credit market conditions to improve and longer still before they begin to have a noticeable impact on activity.

To cushion the downturn in spending, policymakers around the world have cut interest rates and loosened fiscal policy. At home, the MPC has cut Bank Rate from 5% to just 1% in the space of five months. To some degree, the effect of those reductions has been blunted by the problems in the banking sector. But monetary policy is by no means ineffective and, when combined with the sharp fall in sterling of more than a quarter since the summer of 2007, the fall back in commodity prices, and the easing of fiscal policy, will provide a significant boost to demand.

The Committee's latest projection for GDP growth is shown in Chart 1 (GREEN CHART) on page 7 of today's Report. The projection is based on the assumption that Bank Rate moves in line with market expectations, which when the Report was finalised were for Bank Rate to fall to around % in the middle of this year, before rising back to around 3% by the end of the forecast period. The central projection is for output to decline in the first half of this year, so that four-quarter growth falls further in the near term. It is markedly lower than the projection in November, as a deteriorating labour market and increased uncertainty weigh on consumption, companies run down their stocks and scale back investment spending, and the weakness in world demand restrains export growth. Further ahead, output growth increasingly responds to the substantial policy stimulus, an improvement in the availability of credit, and a reduction in the trade deficit as expenditure switches towards home-produced output.

At present, CPI inflation remains well above the 2% target. The Committee's latest projection for future inflation is shown in Chart 2 (RED CHART) on page 8 of the Report, again on the assumption that Bank Rate follows the path implied by market yields. The near-term path of inflation is uneven, reflecting changes in energy prices and the temporary cut in VAT. But in the medium term, inflation falls well below the 2% target, as a substantial margin of spare capacity more than outweighs the waning impact on import and consumer prices from the lower level of sterling.

The prospects for economic growth and inflation remain unusually uncertain, not least because of the extraordinary events of the past few months. The Committee judges that the balance of risks to

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At its February meeting the Committee judged that an immediate reduction in Bank Rate of 0.5 percentage points to 1% was warranted. Given its remit to keep inflation on track to meet the 2% target in the medium term, the projections published by the Committee today imply that further easing in monetary policy may well be required. That is likely to include actions aimed at increasing the supply of money in order to stimulate nominal spending. So let me assure you that, with the full range of instruments at its disposal, the Monetary Policy Committee can and will take action to return inflation to the target and so ensure that economic growth will again match its potential.

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