

## Inflation: Where is it heading?

Professor Joe Nellis

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**Steve Macaulay**

The latest June Consumer Price Index has just come out – it shows a small reduction. Now to put some context around that, and to interpret it, we have in the studio Professor Joe Nellis.

Now, Joe, is this good news?

**Joe Nellis**

Well, yes, it is. The CPI is the Bank of England's inflation target and the target is set at 2% by the government. It has been quite high for some months, so it is reduced from 3.4% to 3.2%, which suggests that the Bank of England is doing what it should be doing – in other words, tracking inflation downwards.

Of course, there is a little bit of uncertainty around this. We had a lot of government spending pre-election, we have now got a lot of government squeeze on the economy post-election. So the question is are we still going to see the pull through of all of that spending continue to push prices up or will the fiscal squeeze pull prices down?

We are in a bit of a quandary at the minute; I think inflation will continue to track down in the coming months, with one or two blips along the way.

**Steve Macaulay**

Most people would like to see that inflation figure go down. One or two people are saying we could do with a bit of inflation here – what do you think?

**Joe Nellis**

Yes; actually it is a more popular view than you might think. Because there is so much debt in the country – personal debt and especially government debt – then any rise in inflation erodes the value of money and therefore the value of debt. So from a very cynical viewpoint, rampant, runaway inflation would solve the government's problems in terms of the debt mountain. But of course, it would destroy the value of money – it would erode the value of money – and therefore anybody with savings would not be happy at all.

So it is a rather interesting dichotomy between those who want more inflation because they have got large debts, those who want less inflation because they want the value of their wealth to be maintained. We are in that rather difficult situation at the moment.

**Steve Macaulay**

Just now for me briefly, there has been a lot of discussion recently about CPI and RPI – what are we talking about here?

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**Joe Nellis** OK; CPI – Consumer Price Index is what we call core inflation. RPI – Retail Price Index is equal to CPI but it also includes mortgage interest payments. And therefore any change in the Bank of England base rate which affects mortgage interest payments, impacts upon the RPI, but does not impact CPI – we strip that out. And the CPI is core inflation because it is trying to measure what is happening to prices independently of any changes in Bank of England interest rate policy.

**Steve Macaulay** So a final piece of advice then for managers, for you and me in the street, what ought we to be expecting?

**Joe Nellis** Well, it is rather a mixed picture, Steve because on the one hand VAT did come down if you remember in January, it is going to go back up next January – January 4<sup>th</sup> – and that is going to affect the RPI (what you might think of as your cost of living, the prices you pay in the shop). So there is going to be a bit of volatility with the RPI.

On the CPI, which I said is the Bank of England's official target given to it by the government, there is confidence being expressed by the Bank of England that the CPI will track down towards the target of 2% in the coming months, and will remain there for many months to come. In fact, they are supposed to keep it there – well plus or minus 1%.

So I think in terms of clarity of answer, the CPI will continue to track down; the Bank of England will take the steps necessary to achieve that. And if CPI remains at around about 2% the consequence is that we can expect interest rates to remain fairly stable for some time to come.

So I think we are in a situation where inflation at the moment is not a problem; the question is what happens in the future in terms of the impact of the government's spending squeeze and then the impact of VAT. And there we have some confusion, as I said earlier.

**Steve Macaulay** I think this is one of those situations where we are going to have to get back together again in maybe six months, nine months time. Thank you very much Joe.

**Joe Nellis** Thank you Steve.