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Monetary Policy - A Perpetual Dilemma? – Speech by Kate Barker

In a speech today to the Charities Consortium, Kate Barker, one of the Bank of England's Monetary Policy Committee members, addressed two current criticisms of the monetary policy framework - that it pays insufficient attention to sectoral divergences, and that more attention should be paid to asset prices.

On the first, she argued that: "It is difficult to construct a clear argument at the macroeconomic level that the balance of the economy over the past five years has been inimical to the UK's growth rate over the medium-term. And, even if that were a concern, no viable alternative monetary policy was available over the past few years which would have produced a better result even for the traded sector."

On asset prices, among other reasons for not attempting to use monetary policy to target misalignments, she said: "Finally there is the question of whether it is the task of monetary policy to protect individuals from the consequences of irrational market judgements. It is of course the task of policymakers more generally to arrange the regulatory framework and ensure that individuals are appropriately protected against the negligence or wrongdoing of others. But within that framework it is unclear how far it is possible or desirable to remove further elements of risk, without the disadvantage of distorting market behaviour."

She concluded: "The bulk of recent criticism, the points which I have tried to address today, stems not so much from a misunderstanding of the framework, but from expecting too much of it. While the MPC is sometimes held to be indifferent to what is happening to manufacturing, the discussion above points out that since we seek to manage the economy as a whole, we care of course about manufacturing, just as we do about every sector, in direct proportion to its importance in the economy. Similarly, we look at asset prices in the same kind of way, assessing the impact of changes in prices on the inflation rate. It would not be possible to direct our attention to specific sectors or asset prices without running other risks."

"In that sense it is wrong to say monetary policy faces a dilemma because of sectoral divergences, or contrary movements in asset prices. We face a series of difficult judgements in balancing these factors - but since we are not attempting to impose on the world a particular growth rate for manufacturing, or level of equity prices, it is not a dilemma as we don't have to choose between the competing pressures. We just have to focus on the target which we are employed to meet. And in fact the experience of the last few years

suggests that this broad approach to policy has enabled a rapid pace of structural change to occur, without knocking the economy as a whole badly off course."

"I have read recently statements such as 'low and stable inflation is not enough' or 'central banks need to do more than just deliver low inflation'. The first seems to me to be true. Of course, in some sense low and stable inflation is not enough. It obviously does not remove all the risks inherent in running a business, or investing in a pension. But it does mitigate these risks to some extent by the implied focus on avoiding swings in the level of economic activity far away from the sustainable growth rate. The second, at least as far as monetary policy is concerned, seems to be largely wrong. Low and stable inflation may not be enough - but it is very much better than high and volatile inflation, or a bout of deflation. And we should not be seduced by the recent record of success into thinking that low and stable inflation is so easy to deliver that central banks can now deliver other things alongside it. Indeed, any attempt to do that would put the achievement of the inflation target at risk. Finally, and obviously, 'just' delivering low and stable inflation actually remains a pretty tricky job."

Key Resources

Monetary Policy - A Perpetual Dilemma? - Full Speech

<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2002/speech178.pdf>