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News release

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Speech by Paul Tucker to the National Association of Pension Funds

In a keynote speech today to the National Association of Pension Funds Annual Investment Conference in Edinburgh, Paul Tucker - Executive Director for Markets and a member of the Monetary Policy Committee - discusses the Bank's commitment to dialogue with financial market participants, domestically and internationally, as an input into its core monetary policy and financial stability mission. On the monetary policy side, he says information from financial markets can be used "as a diagnostic of expectations of economic prospects and of the path of policy," but he stresses that frictions in markets can distort the messages from asset prices and real-world intelligence is required to identify that. On the financial stability side, the Bank is "on the look out for symptoms of actual or incipient stress", and in the event of a crisis would need to comprehend the instruments and structures involved. He says the Bank therefore needs to understand how global financial markets and the key players in them fit together. A wide range of contacts - in the 'core' markets in which the Bank operates but going beyond that - is therefore vital.

On monetary policy, Mr Tucker comments that, with interest rates at 4%, monetary policy is still "stimulating the economy". Looking ahead, he discusses what the terms 'gradual' and 'caution', recently used about interest rates, mean for him. He comments, "If, as projected, output continues to grow above trend then…I for one would expect us [the MPC] to continue gradually to reduce the degree of stimulus to demand broadly in line with the take up of slack in the economy and any consequent pick up in inflationary pressures".

Mr Tucker notes that the term 'caution' may at times have been misconstrued as implying 'hesitant'. He explains that policy-makers care about the extent of the variation in inflation around the target and, therefore, the degree of uncertainty about the effect on inflation of changes in the interest rate. He says, "The marked increases in household debt do somewhat increase that uncertainty. With higher debts relative to incomes, interest rate changes will tend to have a bigger effect on the income that households have free to spend after servicing their debts". Because there is uncertainty about these sensitivities, he says that "other things being equal, policy would tend to move towards neutral more slowly than would otherwise be optimal..."

But the developments in the economy associated with debt accumulation may have other implications for policy. Rising house prices and the associated increased values of collateral available to secure borrowing could have reduced credit constraints faced by some households, and so slightly increased the level of interest rates at which output and inflation are stabilised. Separately, house prices have continued to be stronger than expected over recent months, implying that there is an argument "that policy may need to be tighter than would otherwise be the case in order to arrest somewhat the continuing strength of the household sector…[and so] reduce the risk of an abrupt correction, which would complicate monetary policy and so make achievement of the inflation target more uncertain further ahead." The various considerations need to be weighed together. He says "I would not, however, subscribe to making a surprise policy tightening as a form of shock therapy."

Mr Tucker adds that, overall, the environment for financial stability looks somewhat more comfortable than a year or so ago, though it is not without hazards. These might stem from the 'search for yield' that has been a feature of international markets over the recent past. Global current account imbalances also create risks for financial markets, and there are risks of volatility in fixed income markets given the inevitable uncertainty about the path of US interest rates.

Key Resources

National Association of Pension Funds Annual Investment Conference
Speech by Paul Tucker at the Edinburgh International Conference Centre in Scotland on 19 March 2004
http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2004/speech216.pdf