BANK OF ENGLAND

News release

Press Office
Threadneedle Street
London EC2R 8AH
T 020 7601 4411
F 020 7601 5460
press@bankofengland.co.uk
www.bankofengland.co.uk

22 September 2008

The Credit Crunch and the UK Economy - Speech by Sir John Gieve

In a speech at the Family Office Leadership Summit in London, John Gieve – Deputy Governor of the Bank of England – steps back from financial market developments in recent days and discusses how the credit crunch is affecting the wider UK economy.

He first notes that like other central banks, the Bank of England has "…adapted (its) money market operations to provide the liquidity the banking system as a whole has required.   First, we have allowed banks to increase their reserve balances at the Bank, increasing the size of our overall provision of central bank money; second, within that larger total, we have shifted the balance towards longer-term lending as the terms of market finance have shortened; third, we have widened the collateral we accept for longer-term repos. And in April, we introduced a special scheme to provide banks with up to three years' finance for legacy assets which have become illiquid."

On the inflation outlook, he explains why the risk of inflation expectations drifting up has been such a central concern of the MPC over the last year. He says, "In my view it has been particularly important through recent months, when each forecast has been higher than the one before and each inflation figure has exceeded the earlier forecast, not to confuse the central message that we will set policy to bring inflation back down to target." But on balance he judges that "while we must remain vigilant for any signs of inflation expectations drifting upwards, the news on that front is encouraging."

He emphasises that: "On the other side, the risk we must be careful not to underestimate is the deflationary consequences of the credit crisis… and the news on that front remains worrying. That risk does not just arise from the drama of the last week or two. We will continue to work for the return of calmer financial markets. But we should not rely on that to reverse quickly the broader macroeconomic slowdown that is underway. Indeed there are still risks to the downside."

He concludes that: "At the moment we are focused on the risk that the slowdown in the real economy will be amplified through a contraction in banks' balance sheets. But we should also set in place longer term measures to prevent such financial imbalances from building up again in the next upswing. In my view the case for macro-prudential policies alongside monetary policy is compelling".

http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2008/speech358.pdf