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News release

19 February 2009

Seven Lessons From The Last Three Years - Speech By John Gieve

In his final speech as a member of the Bank of England's Monetary Policy Committee, John Gieve - Deputy Governor for Financial Stability - reviews the economic changes that have occurred during his 3-year term, and draws out seven lessons for the future:

- The limitations of private-sector risk management
- Establish more effective crisis management
- Tighten international coordination
- Develop a new generation of macroeconomic models
- Mopping up after the bust is not a good strategy
- Inflation targeting is necessary but not sufficient
- We need another instrument to stabilise the economy

Perhaps the key lesson is that inflation targeting and monetary policy is not sufficient to ensure economic stability. He argues: "Intelligent inflation targeting on these lines run by independent central banks still seems to me the best foundation for macroeconomic policy. But that does not mean the current framework or the way we explain it is perfect." He argues that it is essential that policymakers explain their strategy to the general public to convince them that inflation targeting is the best way of restoring growth and full employment. He also believes there are powerful arguments for including the cost of home ownership in the target measure of consumer prices. More fundamentally, he outlines the case for an additional policy instrument to smooth the credit cycle and protect the economy from imbalances in financial markets. These should include counter cyclical capital requirements for banks, in setting which the Central Banks should take a leading role.

John welcomes the enactment of the Banking Act, which comes into effect on Saturday 21 February. The Act grants the Bank of England new powers as well as formalising its financial stability objective, providing a more effective system for managing crisis. "Giving these responsibilities to the Bank is the right choice.In effect the Bank has become a second pair of eyes alongside the FSA watching the health of the financial system."

A further lesson is that policymakers need to develop more sophisticated models in order to capture the interactions of the financial sector and the rest of the economy.

He concludes by suggesting that policymakers must always be willing to back their judgements, to intervene in markets and to take pre-emptive action where possible.

Key Resources

Seven Lessons From The Last Three Years – Speech by Sir John Gieve
http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2009/speech377.pdf