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Inflation Targeting: Learning the Lessons from the Financial Crisis - Speech by Spencer Dale

In a speech given today at the Annual Conference of the Society of Business Economists in London, Spencer Dale - Chief Economist and member of the Monetary Policy Committee - talks about inflation targeting and the lessons that should be learnt from the financial crisis. He also addresses some concerns that have been raised about the asset purchase programme.

Spencer Dale points out that the operation of monetary policy over the past year "...demonstrates the strength of the inflation targeting framework in action." The clear numerical target, combined with a framework of transparency and accountability, has been "... instrumental in ensuring that monetary policy has responded boldly and decisively to the events that have unfolded..." The credibility of the target is underpinned by the commitment to the public that ".the Committee will do whatever it takes to hit the inflation target..."

But Spencer Dale acknowledges that recent events must serve as a "...wake up call for policymakers." He considers suggestions that the conduct of policy under inflation targeting should be modified to take account of asset price movements or economic imbalances. He notes that a policy of "leaning against the wind" is difficult to implement, in part because it would not be easy to identify changes in asset prices and economic flows which are unsustainable. But Spencer Dale argues that "...these judgements cannot be ducked." However, he says that short-term interest rates are a blunt instrument and are ".not well suited to the task of managing asset price bubbles and economic imbalances." As such, he argues for an expansion of the range of instruments available to policymakers to manage emerging imbalances.

Spencer Dale notes that the ideal would be policy instruments "which are effective in preventing the build up of asset price bubbles and economic imbalances and efficient in minimising the associated costs to the real economy." But he emphasises that even with a strengthened macroeconomic framework, policy will still require "...finely balanced judgements and difficult decisions" by policymakers. This process of increasing the robustness of the macroeconomic policy framework needs to be "...continuous, not a one-off response to the current crisis."

Spencer Dale then discusses the asset purchase programme and its objective to increase the growth of nominal spending to a rate consistent with meeting the inflation target. He addresses three criticisms made of the programme. One of the criticisms is that the Monetary Policy Committee needs to articulate its exit strategy more clearly. Spencer Dale returns to the importance of the inflation target, and says that "...it will be the outlook for inflation relative to target that will determine the rate at which the current exceptional degree of monetary stimulus is withdrawn as economic prospects recover." He also acknowledges that the most difficult issue for the exit strategy ".will be deciding the timing at which policy should begin to be tightened."

In concluding, Spencer Dale says there are lessons to be learnt from the financial crisis. "The inflation target remains a vital pillar of the macroeconomic policy framework...", but policymakers need instruments suited to managing imbalances. "Policymakers need to make difficult judgements about asset prices and imbalances but they also need effective and efficient tools to enact those judgements."

http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2009/speech395.pdf