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Money, Banks and Quantitative Easing - Speech by David Miles

In a speech today at the 14th Northern Ireland Economic Conference in Belfast, David Miles, an external member of the Monetary Policy Committee, talks about the background to the recent financial crisis and the policy responses, which have included quantitative easing (QE).

David Miles points out that one underlying problem was that "UK banks had a great many assets that had been acquired on the wrong terms; the interest rates charged on them, or the yields implicit in their purchase price, did not allow for their risks." The capital they held was also insufficient given the risks. He goes on to say that the economic issue now ".is how we get through a transition to an economic system that is more sustainable without exacerbating a recession and doing lasting harm to productive capacity."

David Miles believes that ".QE is having an impact and that is relevant to economic conditions right across the country", not just in "...financial markets in London but in high streets and factories and homes throughout the UK." He emphasises that the aim of the operation is to ".increase nominal demand so as to ensure inflation is on target" and argues that the ultimate objective of quantitative easing ".is not to increase some measure of the money supply". He says that in his view, there is ".no intermediate money supply target by reference to which one can definitely judge whether QE is working or not." He continues that movements in a measure of the broad money are ".neither necessary nor sufficient for asset purchases to influence nominal demand in the economy". But the evidence suggests there are ".significant effects of QE and they are the ones which help us to travel on a path towards a more sustainable banking structure" where reliance on bank debt by the private sector ".will likely be lower" and where banks would be ".better capitalised and better able to handle fluctuations in their sources of funding."

He reviews evidence which suggests that quantitative easing has had an impact in reducing the gilt-OIS spread and also corporate bond spreads. David Miles says that the reduction in corporate bond spreads has ".helped to encourage increasing gross and net corporate bond issuance." Turning to the impact of quantitative easing on banks, he notes that as a result ".banks have very quickly come to hold substantially more reserves, so their holdings of liquid assets are far higher." This increase in liquid assets is desirable, and it has come about in a less disruptive way than if banks had quickly tried to run down less liquid assets.

Concluding, David Miles says that quantitative easing will assist spending but also notes it is hard to decide what the ".appropriate scale of purchases is when the power of the mechanisms at work are difficult to gauge." He also notes that the timing and means of reversing this monetary easing will ".depend on the economic outlook, which in turn depends on conditions in financial markets in general and with banks in particular."

http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2009/speech404.pdf