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News release

25 February 2010

Interpreting Monetary Policy - Speech by David Miles

In a speech today at the Imperial College Business School in London - David Miles, an external member of the Monetary Policy Committee - examines the policy of buying assets using the Asset Purchase Facility, know as quantitative easing (QE), and considers the difficulties in setting and interpreting monetary policy in these abnormal times.

David Miles says the February MPC decision to hold the stock of asset purchases at £200bn allows the impact of these purchases on the UK economy to continue. It was a decision to maintain an extraordinarily expansionary monetary policy. Depending on how things evolve in the economy, the stock of purchases may be added to; and at some point in the future it will be reduced. It remains to be seen whether the current policy stance - reflected in the stock of purchases and level of Bank Rate - will still look appropriate as we move through 2010.

In considering the evidence on the impact of QE, David Miles stresses that any assessment has to consider what the counterfactual is: what would have happened had asset purchases been much smaller? He sets out some of the immediate potential effects of QE, which include improving the liquidity of banks and easing pressures in money markets; boosting gilt and corporate bond prices and raising the price of other assets that are alternatives to gilts and corporate bonds, such as equities and commercial property. What has happened to asset prices and to issues of corporate bonds and equities since QE began suggests these effects have been significant. The money supply is also likely to have been boosted by QE. The evidence is that it is substantially higher than one would have expected given the economic environment; some of the positive impacts of QE occur even if the impact on the money supply is zero.
The portfolio re-balancing triggered by QE means that the channels through which QE money flows, and where the money ends up, "...can play out in different ways." There is uncertainty about which are the most important channels through which the money is flowing but David Miles argues that "...most of them are helpful and it seems to me that none, in the current environment, are obviously harmful."
Many of the positive developments in UK financial markets since QE began are mirrored by improvements in the US and the euro zone. Some argue that this shows that QE is irrelevant since the Fed and ECB have not done QE. David Miles looks at the balance sheets of the other central bank, concluding that it is misleading to say the ECB has done nothing comparable in its likely impact to QE and certainly wrong to say that about

the Fed. He says that "...the conclusion that the common signs of recovery across financial markets in the US and euro area imply that the positive signs in the UK are unrelated to the QE policy seems to me to be incorrect." QE on the scale undertaken represents a very substantial easing in monetary policy, which in more normal times would "...be the equivalent of a sharp and substantial reduction in Bank Rate."
David Miles sees no technical problems with varying the stock of asset purchases and Bank Rate to hit the inflation target and "...no reluctance on the part of the MPC to do so." Decisions on monetary policy will be based on the need to hit the inflation target and an assessment of the probabilities of inflation following different paths. David Miles concludes saying that: "There are still more risks of growth not recovering to more normal levels than of substantially exceeding it. And around the most likely outcome for inflation - which moves from well above the target to below it - there are on balance more upside than downside risks. This is one of the reasons why the policy judgement is difficult and in my mind we should be ready to move either way. In judging which way to move it would, however, be a mistake to just focus on the most likely path - the single most likely outcome. That is not how any sensible person makes a decision in a situation of risk and uncertainty. It is not how the MPC should make its decisions. And it is not what we do."

Key Resources

Interpreting Monetary Policy – Full speech

http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2010/speech425.pdf