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The Case for Doing More - speech by Adam Posen

In a speech to the Hull and Humber Chamber of Commerce, Adam Posen - an external member of the Bank of England's Monetary Policy Committee (MPC) - outlines why he believes there is now a case for considering further monetary policy stimulus to support economic recovery. He emphasises that his intent in setting out the case for more policy stimulus is to advance debate on the issue.

On the policy debate, he says "...policymakers face a clear and sustained uphill battle, in which monetary ease has an ongoing role to play, even if it may not deliver the desired sustained recovery on its own. In every major country, actual output has fallen so much versus where trend growth would have put us, and trend growth has not been above potential for long enough as yet, that there remains a significant gap between what the economy could be producing at full employment and it currently produces."

Drawing on his own and wider research on Japan in the 1990s and the US and Europe in the 1930s, Adam Posen outlines what he thinks are the risks to the recovery if errors are made by tightening policy prematurely or loosening policy insufficiently. He says: "The risks that I believe we face now are...ones of sustained low growth turning into a self-fulfilling prophecy, and/or inducing a political reaction that could undermine our long-run stability and prosperity. Inaction by central banks could ratify decisions both by businesses to lastingly shrink the economy's productive capacity, and by investors to avoid risk and prefer cash."

He stresses that his view reflects recent developments that have been broadly consistent with previous patterns seen in Japan in the 1990s and in the United States and Europe in the 1930s. He says, "...economic recovery following a financial crisis is a long process dominated by the interaction of unemployed resources, dysfunctional banking systems, and the degree of policy stimulus. We are a long way from home, and a long, long way from overheating. The absence of any recent data inconsistent with this pattern in the UK or elsewhere in the West seems to me pretty conclusive. If there was going to be a recovery that either was inflationary or otherwise meaningfully different from that established pattern, it should have been evident by now. Absent evidence of a truly different recovery, the analysis of mainstream macroeconomics should apply ...That proven analysis tells us that, under the present circumstances, sustained high inflation is not a threat,

that persistent high unemployment and output gaps are the threat, and we should take further monetary action to sustain and promote recovery."

In considering further monetary easing, Adam Posen advocates further use of government bond purchases. He accepts that the impact of such purchases may have limitations and consideration of alternatives needs to continue. But he says: "Fear of looking ineffective should not be a deterrent to doing the right thing. When facing a worsening situation, you work with the tools you have."

Answering the question of why it might be right to provide more policy stimulus at this stage, he explains that his priors were that it was unlikely that there would be a 'normal' recovery after the financial crisis and that the policy measures taken, although helpful, would prove insufficient. But it was worth putting these central expectations on hold to see whether the emerging recovery following the stimulus provided in the UK and elsewhere was sufficiently strong. As that has not happened, he argues, there is now a case for considering 'doing more'.

Key Resources

The Case for Doing More – Full speech

<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2010/speech449.pdf>