BANK OF ENGLAND

Press Office
Threadneedle Street
London EC2R 8AH
T 020 7601 4411
F 020 7601 5460
press@bankofengland.co.uk
www.bankofengland.co.uk

News release

12 July 2011

Central banking then and now - speech by Charlie Bean

At the Sir Leslie Melville Lecture, delivered at Australian National University, Canberra, Charlie Bean – Deputy Governor for Monetary Policy and member of both the Monetary Policy Committee and Financial Policy Committee – seeks to learn the lessons of the financial crisis for central banks around the world.

Lesson 1 is that, "...in a crisis, central banks need to show flexibility", as Charlie Bean describes the expansion of the Bank of England's balance sheet in pursuit of both its financial and price stability objectives. Furthermore, the crisis has also prompted permanent changes in monetary frameworks such as the expansion by the Bank of England in the range of collateral it will accept in some operations.

Charlie Bean goes on to discuss the interaction of price and financial stability. He argues that in the years leading up to the crisis, "far from fostering financial stability, the Great Moderation may itself have contributed to the build-up of credit and the adoption of risky positions by leading investors to underestimate potential macroeconomic risks". In other words: "...that the long period of relative macroeconomic stability lulled investors into a false state of security". That leads Charlie Bean to his second lesson from the crisis: "...the achievement of price stability does not guarantee the maintenance of financial stability and, without further measures, may possibly even compromise it".

Lesson 3 relates to deficiencies in economists' analytical framework: "...financial intermediation needs to be brought into mainstream macroeconomic analysis". Otherwise, Charlie Bean argues, policymakers are not making proper allowance for its potential role in greatly amplifying economic cycles.

Charlie Bean goes on to discuss what happens when interest rates reach their effective lower bound, as they have done during the financial crisis, and as he suggests might be a more frequent event than previously thought. Empirical estimates of the impact of the MPC's programme of asset purchases (so-called 'quantitative easing') confirm that these purchases can have a substantive impact on the economy. He concludes with Lesson 4: "...central banks do not run out of ammunition when policy rates reach their zero lower bound".

Despite that, Charlie Bean says, it is next to impossible for monetary policy to stabilise economic activity in the face of a financial crisis, leading to the fifth lesson: "...prevention is better than cure". He explains that, while the severity of the recent recession might appear to present a case for monetary policy to 'lean against the wind' in order to moderate credit or asset booms, it is more fruitful to look to instruments other than monetary policy to achieve that task – macroprudential regulation. Charlie Bean argues that "...the empirical evidence suggests the impact of interest rates on credit is generally relatively weak, while capital and liquidity regulation have a very direct impact on leverage and maturity transformation and thus on the resilience of the financial system". So his sixth lesson from the crisis is: "...both monetary and regulatory policies are required to maintain price and financial stability; moreover, monetary policy should remain focused on the control of inflation, while regulatory policies should be assigned to maintaining financial stability".

Key Resources

Central banking then and now – Full speech