BANK OF ENGLAND

News release

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Monetary policy and financial dislocation - speech by David Miles

In a speech delivered to the Royal Economics Society, David Miles – External Member of the Monetary Policy Committee – reviews what can be learned from past asset purchases and what that implies about the impact of more asset purchases now.

David Miles begins by noting just how long the financial crisis has lasted. "That crisis began in August of 2007, became intense in the autumn of 2008 and has not subsided yet. It is over four years since Northern Rock failed in the UK – that is today about as far in the past as the outbreak of the First World War was from the signing of the Armistice." Banking sector problems across much of the world – particularly within Europe - have recently resurfaced. Bad news has arrived on a number of fronts since the August Inflation Report was published. The international growth outlook has worsened and in the UK output surveys have deteriorated markedly, employment growth has slowed and consumer confidence has fallen. Financial market sentiment has also deteriorated considerably. David Miles argues: "Whether the marked deterioration in financial markets and business and consumer optimism will last is hard to know...But monetary policy needs to be set in real time...Right now the likely future levels of UK inflation pressures look to me materially lower than in August." This is why the decision was taken to embark on £75 billion more of asset purchases.

David Miles goes on to review the effects of the Bank of England's asset purchases during 2009/10. Referring to empirical studies carried out by Bank economists, Professor Miles states that: "...a range of estimates...suggested that the asset purchases had about the same effect as a cut in Bank Rate of between 150bp to 300bp, increasing GDP by about 1.5% to 2%." David Miles notes his scepticism about the reliability of many econometric estimates but finds it reassuring that a range of very different techniques give broadly similar results. He says: "...I would certainly take these results much less seriously if these were just apparent empirical regularities for which there was no plausible economic mechanism that could have generated them. Let me put the point in a less negative way. I believe that there are very good reasons for thinking that purchases of government bonds in exchange for money created by the central bank will have an impact on a range of asset prices and will influence the cost and availability of credit to the private sector."

He continues by explaining in more detail the two main channels by which asset purchases ease credit conditions and stimulate demand: the first – more reliable and probably more powerful channel - operating through portfolio rebalancing and the second by potentially alleviating bank funding constraints should they exist.

David Miles concludes that domestic inflationary pressures are lower than he thought in August; and that this, combined with financial market stress and concerns about the stability of the banking sector, lay behind the decision to make further asset purchases. He is sceptical of the arguments that the impact of further asset purchases will be less than in 2009 even though gilt yields are now lower.

Notes to Editors

1. The Bank of England Monetary Policy Committee (MPC) first announced that it would undertake a programme of asset purchases following its meeting on 5 March 2009.

2. The MPC voted to increase the size of the asset purchase programme by £75 billion to a total of £275 billion following its meeting on 7 October 2011.

3. Further details about the Committee's interest rate decisions can be found on the Bank's website: **http://www.bankofengland.co.uk/monetarypolicy/decisions.htm**

Key Resources

Monetary policy and financial dislocation – Full speech