BANK OF ENGLAND

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18 April 2012

Credit conditions for firms: stability and monetary policy - speech by Paul Tucker

Speaking to the Association of Corporate Treasurers in Liverpool today, Paul Tucker – the Bank's Deputy Governor for Financial Stability and a member of the Monetary Policy Committee (MPC) – addresses some of the issues facing businesses as the economy rebalances and the financial system rebuilds. He talks about credit conditions and how the Financial Policy Committee (FPC) might affect businesses. And he surveys the outlook for monetary policy, taking into account news on growth and inflation since the February Inflation Report. He notes that while "the overall story of recovery in underlying growth still looks broadly intact, there has been bad news on the inflation front."

Paul Tucker says that firms have had to "navigate a demanding obstacle course while the real economy 'rebalances'". He emphasises the compounding effect of the headwinds facing the financial system. Pointing to the increasing importance of bond market financing for large companies, he says that such firms "may, for the moment, be well placed to support the financing of smaller firms....But it is fanciful to entertain the notion that anyone other than the banking system can be the main backstop for working-capital finance". He notes the historical role of bankers' acceptances in trade finance, and says that although he has wondered more than once whether a revival would be useful, "That is for you, as corporate treasurers, and bankers to pursue if you wish to". He also describes the Bank's Secured Commercial Paper Facility, which was launched a couple of years ago. He notes that invoice-based financing by banks has increased, but take-up of the Bank's facility has been limited, although it remains open. While important, improvements in working capital finance are, he says, insufficient. "For longer-term finance, I hope that businesses and the City can work together to broaden access to the corporate bond markets". Outlining various initiatives already underway, he says "securitisation might even play a role" but emphasises the importance that the lessons from badly designed securitisations in the past are learnt. "Sadly, the repair of the credit system will take time".

Describing the process of putting in place better 'rules of the game' for the financial system, Paul Tucker says that "for all the measures in train ... they will I fear eventually be found wanting". The FPC, he says, is "the body charged with being on the case". He notes that both macroeconomic policymakers and financial regulators have had to learn lessons. "On the one hand, we all need to be attentive to the effects that easy monetary policy globally can have on risk-taking behaviour. On the other hand, financial regulators cannot

afford to focus exclusively on the health of individual banks and dealers as though they were isolated atoms ... The FPC is about filling the space between monetary policy and microregulation – in an admittedly inelegant phrase, 'macroprudential' policy: policy that is focused on the resilience of the system as a whole."

Paul Tucker notes that "the burden of stimulating our economic recovery falls mainly to monetary policy". He highlights that, although temporary factors are likely to muddy the signals from the official data and leave headline growth "well short of what has been suggested by surveys", the MPC's view on the outlook for underlying growth from the February Inflation Report "still looks broadly on track". He emphasises that the MPC will remain focussed on indicators of underlying activity, which point to "modest growth, but growth nonetheless".

"Easily the Committee's biggest judgment in recent years has been that inflation will gradually fall back to the 2% target". Paul Tucker says that increases in oil and gas prices, combined with duty changes announced in the Budget, seem likely to him to leave the short-term outlook for inflation on a path "a little higher than incorporated into the central projection described in the MPC's February Inflation Report. I think inflation might remain above 3% throughout the second quarter of this year, and possibly into the second half of the year."

Paul Tucker notes the upside risks to the central projection which existed at the time of the February Inflation Report, for example potential supply disruptions to oil production. "One possibility is that companies have begun to rebuild or protect their profit margins more quickly than expected ... Companies' willingness to tolerate a further squeeze, in the face of rising import prices, might be limited". Central to the Committee's deliberations will, he says, be the extent to which spare capacity is dragging down on prices, and the outlook for productivity. "But with productivity growth having been incredibly low for a while now, it is possible that the rate of earnings growth consistent with achieving the 2% inflation target has been below the 4 - 4.5% we typically used as a rough benchmark in more normal conditions before the financial crisis and subsequent recession."

But Paul Tucker emphasises that the issue is what path inflation takes back to target, not whether it will return to target. "The MPC will ensure that it does return to target and that medium-term inflation expectations are anchored to the target... We shall not let that slip."
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Key Resources

Credit conditions for firms: stability and monetary policy (44KB)
http://www.bankofengland.co.uk/publications/Documents/speeches/2012/speech564.pdf
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