BANK OF ENGLAND

News release

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Policy making at the Bank of England: the Financial Policy Committee – speech by Paul Fisher

Speaking in London today, Paul Fisher – the Bank's Executive Director for Markets and member of both the Monetary Policy Committee (MPC) and the Financial Policy Committee (FPC) – speaks about the Bank's new responsibilities for financial stability. Paul focuses specifically on the FPC, which is being established as part of the wide-ranging overhaul of the UK's financial stability arrangements, and will have responsibility for making the financial system as a whole more resilient. He sets out the progress and recommendations of the FPC to date, and some of the potential challenges going forward.

Discussing the Bank's recent role in financial stability, Paul notes that there was little the Bank was empowered to do about the build-up of leverage and unsustainable debt in the period preceding the crisis. Policymakers cannot achieve two different policy objectives with a single policy instrument, he says. Even with hindsight, "raising interest rates further in an attempt to restrain the leverage of banks or the indebtedness of households and firms would have necessarily meant missing the inflation target on the downside". He outlines the changes to the UK's system of financial regulation underway to redress the policy making gap, of which the establishment of the FPC forms a crucial part, and which he describes as "truly groundbreaking".

Paul notes that in pursuing macroprudential policies it will be the FPC's role to supplement "bottom-up" microprudential supervision by addressing system-wide risks "top-down". That involves detecting and reducing threats to the financial system as a whole, and ensuring that the flow of financial services to the wider economy is maintained. This, he concedes, "is a tough ask". He notes that expectations of maintaining financial stability continuously would be over-optimistic – "just as monetary policy makers will never be able to abolish the business cycle, financial policy makers will never be able to abolish the credit cycle. Instead, the best contribution we can make to financial stability is probably in making the system as a whole more resilient, so that the costs of any specific financial instability shocks are reduced."

Paul notes concerns raised by the Treasury Committee over the potential for conflict between the decisions and objectives of the MPC and FPC and argues that this is not the problem that it may appear to be, citing results from the economics literature. Separate policy committees, each with a single clear responsibility and independent instruments should be able to achieve different objectives. Co-ordination can be ensured by cross-chairing and co–membership of the two committees.

Paul accepts there will be challenges and trade-offs for both committees to wrestle with. The FPC faces particular challenges in the current conjuncture – the concept of macroprudential frameworks originates in the context of “taking away the punchbowl before the party gets started”, but little has been written about “how to cure the hangover after the party has ended”.

Although not yet on a statutory footing, Paul notes that the FPC is already up and running and making policy recommendations which will make a difference, including encouraging banks to build capital levels opportunistically. He also discusses how the interim FPC will shortly be making formal recommendations to HMT on the tools over which the FPC should in due course have directive powers, and how it will also be responsible for advising the Government on which parts of the financial system should (and should not) be subject to regulation.

Paul concludes by offering some personal reflections on the FPC so far. He believes closer co-ordination between the Bank and the FSA, through an improved dialogue and through sharing insights provided by the Bank’s extensive market intelligence programme, is already reaping benefits for the FPC. He also notes the communications challenges associated with macroprudential policy. “It is important that everyone with an interest in the financial sector is aware of what we are trying to do, so that they can participate in the debate about macroprudential policy, and so that they know what progress has been made towards achieving a safer and more resilient financial system.”

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