BANK OF ENGLAND

News release

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

26 February 2013

Current issues in monetary policy

Speaking in London today, Paul Fisher, the Bank's Executive Director for Markets and a member of both the Monetary Policy Committee (MPC) and the Financial Policy Committee (FPC), discusses what central banks can do to help achieve low inflation, stable growth and full employment. He also talks about the monetary policy decisions facing the MPC currently including his own recent votes, and provides an update on the Funding for Lending Scheme.

Paul Fisher starts by explaining the role of the Bank of England's balance sheet in enabling it to deliver its core functions. He notes that the ability of the Bank to control the amount of narrow money in the economy, and / or its price, is the fundamental tool it has to implement monetary policy. Those operations combined with the ability to alter the composition of its balance sheet, and to conduct off-balance sheet operations enables the Bank to influence the price and / or quantity of particular types of credit in the economy. And finally, by talking about what they might do in the future, the MPC can influence the price and quantity of money and credit for some time to come. "The power of communications as an operational tool should not be underestimated and the MPC has always used a range of communication channels".

Paul Fisher explains that through its quantitative easing (QE) programme, the Bank has moved from adjusting the price of money to directly affecting the supply of money. He notes that while QE is often described as a great experiment, the theory of monetary policy has always considered the supply of money to be the central bank's primary policy instrument. But although QE has increased the supply of narrow money, other offsetting factors have meant that growth in the stock of broad money in the economy has remained weak. That does not mean QE has been unsuccessful. Without it, "the amount of broad money in the economy would clearly have shrunk much further … the resulting deflation would have meant that the outcomes for output and employment in the UK would have been far, far worse than they have been".

Paul Fisher also describes the Bank's operations in corporate credit markets, highlighting that by acting as 'Market Maker of Last Resort', the Bank has been able to support the markets for both commercial paper and corporate bonds. He notes that the corporate bond scheme is still in operation. Of the suggestion that the Bank should buy corporate bonds in large scale, he says "it is not clear to me what this would be intended to achieve. Apart from the simple fact that the Bank is already in the market every week offering to

buy corporate bonds, and we have been doing that for nearly four years, this aspect of the capital markets is functioning well in terms of providing credit to businesses ... The backstop to corporate bonds provided by the Bank's operations is still there – but it is not being used much because it is not needed." He underlines that the power to intervene in credit markets "is one to use cautiously. Any intervention by the public sector carries the risk of creating distortions."

Paul Fisher says he does not believe the assertions of those who claim that QE is noticeably less powerful than previously. Speaking of the most recent monetary policy decision, he says that his own choice, "on a balanced assessment of the risks, was that we could and should do more now to support a nascent recovery with a further monetary injection ... As long as medium-term inflation expectations do remain consistent with our objective." "But there is a case for taking a slightly longer-term approach than previously ... Rather than a very large, rapid programme of asset purchases to avoid an imminent slump – as was needed in 2009 and again in 2011/12 – a slower, more gradually supportive policy might be more appropriate and less risky to nurse the economy through the next phase of recovery". Having voted for a £25bn extension at the February meeting, he said his thinking was that "this could be the first instalment of a more prolonged run of purchases." That way, "it would be straightforward to accelerate or to stop purchases as the economic outlook developed and the risks became clearer ... the Committee will keep all its options open".

Turning to the FLS, Paul Fisher states that the first phase – cutting the funding costs of banks – has been "remarkably successful". The next stage – banks passing on lower funding costs to their customers – "is happening". The final stage – the impact of lower lending rates on the quantity of credit – will take some time to work through from applications to approvals to actual lending. The eventual impact will depend on the demand for credit and the creditworthiness of borrowers. But, he says, "we do need to keep the pressure on the banks individually and collectively to make sure that they continue to pass through lower funding costs and are lending where they can ... it is up to the banks to deliver". He says the next data release on 4 March, for end-December data, will still be quite early for much money to have actually flowed from the application stage into actual loans. "I would not expect to see a return to rising aggregate quantities until we start getting data for 2013 at the earliest". He notes that a revival in mortgage activity is visible in the approvals data and that trend is widely supported by business contacts throughout the country. But, he notes, the underlying message from the FLS is the same as for monetary policy: "Monetary and credit policies can help provide the foundations for growth and ease the path for necessary real adjustments. But ultimately, the growth of the economy will depend on real factors such as expectations of real income growth and the productivity of UK firms and workers."

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