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Central bank asset purchases and financial markets – speech by David Miles

In a speech delivered at the Global Borrowers and Investors Forum, David Miles – External Member of the Monetary Policy Committee (MPC) – considers the evidence on the impact of central bank asset purchases, assesses whether they are causing distortions in the financial markets, and offers some thoughts on how the exceptional setting of monetary policy we see today in the UK might ultimately be normalised.
David Miles begins by reviewing the evidence for the argument that asset purchases by central banks have caused generalised bubbles in financial asset prices. He looks at share prices, house prices, UK government debt and corporate bonds and concludes that the evidence for this argument is weak. He argues: "In the UK there is more evidence that the Bank's asset purchases helped to stop an anti-bubble, that is, a downward spiral in asset prices that would have further damaged the real economy and become dangerously self-reinforcing."

David Miles also finds little to support the view that asset purchases have both created multiple asset bubbles while having no impact on boosting demand in the economy. "What I find implausible about this is the idea that a rise in the value of assets, and a fall in the likely future return on savings, could have no effect on stimulating someone's spending." He concludes "…I think there is a far more plausible, and rather less sensational view,…that it [QE] has supported a wide range of asset prices and that this has caused spending to be higher than it would otherwise have been."

Turning to the normalisation of exceptional monetary policy, David Miles states that the market environment in which an un-wind of asset purchases takes place is crucial. He says that QE has had a considerable impact during the crisis because financial markets were not functioning well. When it is reversed, it is likely that financial markets will be working more normally. David Miles refers to a simple model he is developing to obtain a clearer idea about how strong the impact of sales of gilts might be in an environment where financial markets are functioning more normally. The initial results suggest that "purchasing assets in times where financial markets are dysfunctional, and selling them when markets work well, might well be part of an optimal monetary policy strategy…a gradual unwind may be smooth."

Finally, David Miles looks at how the Bank of England's balance sheet might change in the future. He concludes that: "In the UK the unwind of the huge expansion of the central bank balance sheet need not be complete because commercial banks will be very likely to want to hold more reserves than the tiny sliver that they thought adequate before the financial train wreck."