BANK OF ENGLAND

# News release

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## Unconventional monetary policy – a speech by Martin Weale

In a speech delivered at Nottingham University, Martin Weale discussed a range of unconventional policy options available to central banks. He underlined that he not believe the Monetary Policy Committee (MPC) will need to expand its use of unconventional policy any time soon, but it was important to assess these options as “the Committee does not want to be a monetary equivalent of King Æthelred the Unready”.

Martin analysed the historical experience of the four main unconventional strategies that had been deployed by central banks: quantitative easing; forward guidance; monetary finance; and negative interest rates.

On **quantitative easing**, Martin outlined his own analysis of its impact in the UK and US. While noting arguments that QE would be less effective now than it had been in the past, Martin said his own analysis contradicted that suggestion – a finding which was part of the reason why he had been more inclined to vote for interest rate rises than his colleagues in recent years: “There is less reason to delay policy tightening if you are confident that you have a means of providing material further support should it be needed”.

In addition, Martin pointed out that the MPC could, in future, expand the range of assets it purchases under QE, noting that in the early 1980s it held substantial amounts of non-government securities. He said: “While there were, at that time, very good reasons why the Bank of England did not want to make substantial purchases of private-sector assets, it is not clear to me how far those are necessarily an insuperable obstacle.”

Turning to **forward guidance**, Martin found that state-contingent forward guidance tended to have a “relatively modest effect on output and inflation.” Martin noted that this finding depends on where the relevant threshold was set and, in any case, the MPC has only considered such thresholds as reference points rather than rules. Without a rule-based system, he argued, it is hard to be clear about the circumstances in which this sort of state-based guidance will be used, and thus its impact cannot be easily evaluated. He said: “The Monetary Policy Committee does not follow a rule for interest rates and it therefore cannot amend such a rule. It can, of course, do what it did in August 2013, but it is not clear how such a policy can be transformed into a general part of the policy armoury in a way which makes it possible to assess its effects”.

Moving beyond policies the Bank of England has pursued in recent years, Martin stated that – assuming that central bank reserves would continue to be remunerated – he struggled to see a clear difference between some versions of **monetary finance** and QE. The difference between the two, conceptually, has generally been that the former is seen as permanent and the latter as temporary. However, Martin noted it is not possible for a government to force its successors to maintain a 'helicopter drop' as a permanent feature of the landscape. He said: "That is not to say that asset purchases are monetary financing…but rather that an attempt at monetary financing may blur into something not very different from asset purchases, in that both shorten the maturity of public sector debt." He observed that if some form of reserve requirement were imposed, with reserves unremunerated, the effect was not very different from a tax on banks which would eventually lead to lower spending.

Addressing recent global discussions about **negative interest rates**, Martin believes they "probably do provide some support, but the extent of this depends on how banks behave, and whether they are able to pass on the full amount of the rate reduction to borrowers". However, while some challenges – such as banks moving reserves from central banks into cash – could potentially be overcome, Martin underlined that "there is a risk of adverse side-effect and it would be wrong to introduce negative interest rates without being confident that these side-effects were going to be small." He added: "Equally, measures designed to protect the domestic economy from the effects of negative interest rates mean that the policy becomes close to one of beggar-my-neighbour exchange rate management".

Martin concluded by arguing that "it is appreciably more likely that monetary tightening rather than monetary easing will be needed in the United Kingdom over the next two years", noting that financial markets and commodity prices have recovered over the last month, while disappointing recent productivity indicated that unit labour wage costs were stronger than is apparent in headline wage figures. "Nevertheless", he concluded, "should the need for further easing arise because of a sharp weakening in the outlook for inflation, the scope for further asset purchases is substantial, while the obstacles we saw to reducing Bank Rate below 1/2 per cent are no longer material. These observations should allay concerns that it will be difficult to bring inflation back to target".

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