Bank of England speeches

A short summary of speeches made by Bank personnel since publication of the previous *Bulletin* are listed below.

What should be done about rising unemployment in the United Kingdom?

David Blanchflower, Monetary Policy Committee member, February 2009.

www.bankofengland.co.uk/publications/speeches/2009/speech379.pdf

In this speech, David Blanchflower explained that while monetary and fiscal policy could stimulate the economy in the short term, the medium-term prospects for growth relied on a healthy financial sector to channel savings into the most productive investments. One risk to the economic outlook was that large increases in unemployment, coupled with negative equity in the housing market, could lead to rising arrears and defaults on mortgage loans. This scenario would imply further profit losses for banks. To help mitigate this risk any fiscal stimulus should be concentrated on sustaining employment and raising the human capital of the young, rather than being focused on large-scale, costly training schemes that had been ineffective in the past.

Monetary policy and the current recession

Andrew Sentance, Monetary Policy Committee member, February 2009.

www.bankofengland.co.uk/publications/speeches/2009/speech378.pdf

In this speech, Andrew Sentance described the characteristics of the current recession and how it compared with previous UK recessions. He noted that although this recession is unusual in being driven by a global financial crisis there are familiar patterns in the components of demand and the sectors of the economy which are being affected. He went on to discuss the main challenges for monetary policy in the current economic climate. Risks to inflation were skewed to the downside but lower interest rates and a competitive pound should help to support the UK economy over the course of the year. Quantitative easing would also provide an additional tool to limit the downward pressures on demand. Consequently, monetary policy could continue to make a substantial contribution to economic stability over both the short and long term provided it remained focused on price stability.

Seven lessons from the last three years

Sir John Gieve, Deputy Governor, February 2009.

www.bankofengland.co.uk/publications/speeches/2009/speech377.pdf

In his final speech as Deputy Governor, John Gieve looked back at the period of Great Stability and described seven lessons from his time at the Bank of England. First, he believed regulators should have a say in banks' risk management, as the recent crisis has shown that banks relied too heavily on flawed systems. Second, he outlined the gaps that existed in the United Kingdom's arrangements for resolving failing banks. He welcomed the new arrangements established by the Banking Act which bridge those gaps. Third, he noted that international co-operation and co-ordination procedures for resolving cross-border institutions were lacking and needed improvement. Fourth, he argued that the current generation of macroeconomic models used by central banks have drawbacks that need to be addressed. Fifth, he proposed that it may be less costly to avoid a bubble forming in financial markets than simply 'mopping up' after the crash. Sixth, he believed that central banks should adopt an 'intelligent approach to inflation targeting' to counter asset price booms and credit expansion. His final lesson was that the authorities require another instrument to stabilise the economy. He considered what form the instrument could take and who should be in charge of it.

Opening remarks for an LSE panel on the global economic crisis: meeting the challenge

Timothy Besley, Monetary Policy Committee member, February 2009.

www.bankofengland.co.uk/publications/speeches/2009/speech376.pdf

In this speech, Professor Tim Besley described the three main elements of the policy responses to the downturn. The first is a series of measures aimed at limiting directly the fallout from the financial crisis — including efforts to improve liquidity in financial markets, to recapitalise banks and to limit the impact of their 'difficult to value' assets on their lending activity. The second is the loosening of monetary policy — mainly so far by lowering official policy rates. Third, there have been fiscal policy responses, which are geared towards supporting demand in the face of weakening private investment spending and softening household demand. Professor Besley concluded that direct measures to prevent a sharper-than-desirable credit contraction should be understood and evaluated against the background of clearly defined policy objectives. The inflation-targeting framework with independent decisions by the MPC remains in his view a sound structure for monetary policy in the United Kingdom.

The economic outlook

Charles Bean, Deputy Governor, February 2009.

www.bankofengland.co.uk/publications/speeches/2009/speech375.pdf

In this speech, Charles Bean described how the crisis in the financial sector caused the current recession. He highlighted the importance of the shock from the collapse of Lehman Brothers in triggering a worldwide collapse in credit availability and confidence. Although the near-term outlook remains weak, he argued there are grounds for believing conditions would improve later in the year because of the stimulus from large cuts in Bank Rate, the large depreciation of sterling and the various measures implemented to support the banking system. He concluded by arguing the case for an additional policy instrument to curtail excessive exuberance in the financial sector.

Why banks failed the stress test

Andrew Haldane, Executive Director for Financial Stability, February 2009.

www.bankofengland.co.uk/publications/speeches/2009/speech374.pdf

In this speech, Andrew Haldane diagnosed some of the market failures in stress-testing practices highlighted by the financial crisis of the past 18 months. These roughly fall into three categories: disaster myopia, network externalities and misaligned incentives. He then went on to propose a five-point plan for improving stress-testing practices going forward to address these weaknesses. These measures involved better specification and regular evaluation of stress scenarios, including their second-round effects; plus a greater degree of engagement between risk managers and senior management and between financial firms and the authorities. They would also involve much greater public transparency about risk metrics and accompanying management actions.

Macroeconomic policy responses in the United Kingdom?

David Blanchflower, Monetary Policy Committee member, January 2009.

www.bankofengland.co.uk/publications/speeches/2009/speech373.pdf

In this speech, David Blanchflower described that a range of survey measures of UK economic activity had fallen to historic lows and the outlook for the global economy had deteriorated significantly. In past recessions, forecasts for economic activity had failed to anticipate the duration of the downturn. And past episodes of financial crises had been associated with particularly severe declines in output. Hence, UK economic activity was likely to contract further. As the degree of spare capacity within the economy increased there was a risk annual CPI inflation could fall below zero. Recently announced fiscal and monetary policy initiatives would provide an effective stimulus to the economy, but further policy action was required.

The Governor's speech to the CBI Dinner, Nottingham, at the East Midlands Conference Centre

Mervyn King, Governor, January 2009.

www.bankofengland.co.uk/publications/speeches/2009/speech372.pdf

In this speech, the Governor argued that the crisis — driven by the build-up of global imbalances and the explosion in the financial system — pointed to the need to create a new policy instrument to limit the build-up of debt. Bank Rate should be used for its traditional task of targeting inflation, rather than being diverted to try to control financial imbalances. The Governor pointed to a 'paradox of policy', where almost any policy measure that was desirable in the short run was diametrically opposite to the direction policy would need to take in the long run. In the short run spending must be encouraged to support the economy, but in the long term we would need to save more as a nation. Similarly banks should be encouraged to run down their capital now to enable them to absorb losses while continuing to lend, but in the long run they would need more capital. That suggested a need for clear policy frameworks to guide the policy response. In the area of monetary policy that framework is provided by the inflation target. With Bank Rate already very low, the MPC were preparing for the possibility that they may need to consider a range of unconventional measures to meet their remit. Those would need to be carefully designed.

Economic prospects and the policy challenge

Sir John Gieve, Deputy Governor, January 2009.

www.bankofengland.co.uk/publications/speeches/2009/speech371.pdf

In this speech, John Gieve described the economic situation and the challenges for policy. The current recession was unusual, compared with previous post-war recessions, in that it was not preceded by a boom in output growth leading to rising price inflation. But there had been a sharp rise in household and corporate indebtedness associated with a surge in many asset prices. When losses emerged in the US sub-prime market, this ricocheted through the global financial system, eventually leading to a collapse in confidence across the world. In the United Kingdom there had been a sharp and broad-based weakening in activity reflecting a squeeze on credit, lower confidence, and falling external demand. Past policy measures — lower interest rates and looser fiscal policy

— combined with a lower exchange rate would have a growing effect on the economy in the short term by stimulating demand. Though in the medium term, we needed to see higher saving rates, less leverage in the financial sector and higher net exports. It would also be necessary to supplement monetary policy action with measures directly focused on banking and financial markets.

The current downturn — a bust without a boom?

Andrew Sentance, Monetary Policy Committee member, December 2008.

www.bankofengland.co.uk/publications/speeches/2008/speech370.pdf

In this speech, Andrew Sentance discussed how the current downturn was different from other post-war recessions which had been preceded by an inflationary boom. Instead, the current cycle looked similar to those that occurred before the First World War which had been driven by financial and commodity booms. Dr Sentance offered three policy conclusions. First, the two-way interactions between the financial system and the macroeconomy need to be better understood. Second, better policy instruments for maintaining the stability of the financial system, and avoiding financial booms, need to be developed. Third, the inflationary consequences of strong demand growth may have been masked, perhaps by the inflation of a financial bubble or because of globalisation. This suggested that the future growth of supply potential may be lower than previously thought.