

## Bank of England speeches

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

### [The Great Moderation, the Great Panic and the Great Contraction](#)

Charles Bean, Deputy Governor, August 2009.

[www.bankofengland.co.uk/publications/speeches/2009/speech399.pdf](http://www.bankofengland.co.uk/publications/speeches/2009/speech399.pdf)

Charles Bean delivered the Schumpeter lecture at the Annual Congress of the European Economic Association. In the lecture he looked back at the causes of the financial crisis and subsequent recession. He discussed macroeconomic factors. The decade of unusually stable activity in advanced economies leading up to the crisis had created a false sense of security. Real short and long-term interest rates were also low due to loose monetary policy and strong global savings. He also discussed microeconomic distortions in financial markets which created strong incentives for financial institutions to become highly geared. He also described the severe information problems created by highly complex financial instruments. When losses grew, the financial sector was impaired because the complexity of the interbank network created enormous uncertainty about the extent of counterparty risk.

Uncertainties in the financial system were transmitted to the real economy after the collapse of Lehman Brothers which made the task of deleveraging in the financial system more difficult and the tightening of credit more severe. Mr Bean discussed whether central banks should use monetary policy to counteract credit cycles but concluded they should develop macroprudential instruments instead.

He argued that there are lessons for the economics profession to learn but it does not need radical change because much of what went wrong can be analysed using standard economic tools. Economists should take more notice of history and not treat crises as pathologies but as a central feature of free-market economies that models should aspire to explain. Finally, macroeconomists have to put credit markets into their models which enable us to examine shocks originating in the financial sector rather than just as an amplification mechanism.

### [Opening remarks for panel on the macroeconomy and quantitative easing](#)

Tim Besley, Monetary Policy Committee member, July 2009.

[www.bankofengland.co.uk/publications/speeches/2009/speech398.pdf](http://www.bankofengland.co.uk/publications/speeches/2009/speech398.pdf)

In this speech, Professor Tim Besley described three issues relating to the transmission mechanism for monetary policy. The first issue was the motivation for quantitative easing (QE), which Professor Besley described as '...the natural way to conduct monetary policy when nominal interest rates hit their effective lower bound'. The second was recognising the importance of financial frictions in affecting the transmission mechanism of monetary policy — inhibiting the transmission of Bank Rate onto the real economy and also affecting the transmission of QE. Third, the implications for future policymaking from the use of QE and existence of such frictions — and the problems of interpreting current policy using a simple policy rule. Professor Besley concluded that there will be a need to pay greater attention to the role of financial frictions in the monetary policy transmission mechanism, but that the ability to move into QE indicated that the inflation-targeting framework with monetary policy independence remains strong.

### [Small lessons from a big crisis](#)

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

[www.bankofengland.co.uk/publications/speeches/2009/speech397.pdf](http://www.bankofengland.co.uk/publications/speeches/2009/speech397.pdf)

In this speech, Andrew Haldane discussed seven issues arising from the crisis and assessed their implications for policymakers and practitioners. These included a role for a systemic overseer in detecting exuberance in financial markets and institutions; the need for banking returns to more accurately reflect risk, especially when higher returns are generated from higher leverage and hence risk; the need to reassess the Modigliani-Miller hypothesis in a banking context to understand why raising equity is perceived as costly; the importance of other markets learning lessons from the robustness of payment and settlement infrastructures exhibited during this crisis; and the need for fundamental reform of post-trade infrastructure in over-the-counter financial markets.

### Regimes for handling bank failures: redrawing the banking Social Contract

Paul Tucker, Deputy Governor, June 2009.

[www.bankofengland.co.uk/publications/speeches/2009/speech396.pdf](http://www.bankofengland.co.uk/publications/speeches/2009/speech396.pdf)

In this speech, the third of a series on redrawing the 'Social Contract' for banking in the light of the financial crisis, Paul Tucker discussed the need for banks to organise and manage themselves in a way that facilitates the orderly management of crises, including through deposit insurance and the resolution of distressed firms. He explained how the banking system should bear the cost of insuring retail depositors against loss, through a risk-based, pre-funded system of deposit insurance. Pre-funding ensures that you are not trying to collect levies from risky banks after they have failed. Risk-based premia are necessary to head off risk-taking by banks on the back of *de facto* 100% deposit insurance for retail depositors. Further to their role in funding the deposit insurance scheme, banks also need to structure themselves to permit their orderly resolution should that be required. As part of that, banks needed to maintain and provide better information to facilitate rapid payout to retail depositors by the Financial Sector Compensation Scheme; to aid the Bank of England's choice and execution of resolution tools under the United Kingdom's Special Resolution Regime; and for potential bidders for part of or all a failed bank. This will require a major change in the information banks have about themselves.

Tucker argued that banks should maintain a realistic resolution plan for how they could be derisked and, if necessary, wound down in an orderly way. That now had to be part of the banking Social Contract. It would probably entail a radical simplification of some group structures. That would not be easy. But it was important to bring about the kind of regime shift necessary to restore confidence and trust in the industry without a government prop.

In relation to the cross-border aspects of bank resolutions, he noted the potential tension between the regulatory division of labour in normal times and insolvency or resolution regimes, which in distressed times can effectively split banks into a series of *de facto* ring-fenced entities. The Financial Stability Board's 'Principles for Cross-Border Co-operation on Crisis Management', which were endorsed by the G20 Heads of Government, have the potential to bring about material changes in the way banks structure their businesses, in how they interact with the authorities, and in the wider environment in which they operate.

### Inflation targeting: learning the lessons from the financial crisis

Spencer Dale, Executive Director and Chief Economist, June 2009.

[www.bankofengland.co.uk/publications/speeches/2009/speech395.pdf](http://www.bankofengland.co.uk/publications/speeches/2009/speech395.pdf)

In this speech, Spencer Dale talked about inflation targeting and the lessons that should be learnt from the financial crisis. He then addressed some concerns that had been raised about the asset purchase programme. The dramatic easing in monetary policy over the previous year demonstrated the strength of the inflation-targeting framework in action. But recent events needed to serve as a wake-up call. The need to make difficult judgements meant that a policy of 'leaning against the wind' would be difficult to implement, but these judgements could not be ducked. However, short-term interest rates were not well suited to the task of managing asset price bubbles and economic imbalances, so an expansion of the range of instruments available to policymakers was needed. The ideal would be policy instruments that were effective in preventing the build-up of asset price bubbles and economic imbalances and efficient in minimising the associated costs to the real economy.

### The Governor's speech at the Mansion House

Mervyn King, Governor, June 2009.

[www.bankofengland.co.uk/publications/speeches/2009/speech394.pdf](http://www.bankofengland.co.uk/publications/speeches/2009/speech394.pdf)

In this speech, the Governor noted that the macroeconomic outlook is particularly uncertain. There were reasons to be optimistic about the outlook but the continued weakness of bank lending suggested a need for caution. He also noted that although it is too soon to reverse the extraordinary policy stimulus that has taken place over recent months, it is not too early to prepare for such exit strategies and explain how they would work.

He argued that we must learn lessons from the events of the past two years. One key lesson is that price stability does not guarantee stability of the economy as a whole. But this does not mean that monetary policy should be diverted from its goal of price stability. That would risk making the economy less stable and the financial system no more so.

Instead new instruments to pursue financial stability are required: a 'macroprudential' toolkit to reduce risk across the financial system. But the 'macroprudential' toolkit should not be put together in a hurry. And, more generally, we will need to reflect more deeply on the lessons from the crisis before designing a regulatory response.

Finally, the Governor noted that the Bank needs suitable powers if it is to be able to meet its new statutory responsibility for financial stability.

#### The road to recovery and the inflation target

Paul Fisher, Monetary Policy Committee member, June 2009.

[www.bankofengland.co.uk/publications/speeches/2009/speech393.pdf](http://www.bankofengland.co.uk/publications/speeches/2009/speech393.pdf)

In this speech, Paul Fisher looked at the events of the worldwide slowdown, and the role and reaction of monetary policy, outlining in particular how the MPC first reduced Bank Rate and then adopted unconventional asset purchases in pursuit of the inflation target. He set out the various channels through which asset purchases should work.

He challenged the notion that the UK inflation-targeting regime had in some sense 'failed' given that the economy was in recession. Most developed countries had seen a recession, irrespective of their monetary policy regime or stance. It was unlikely that an alternative framework could have prevented some degree of recession given the shock to the global financial system. Moreover, there were reasons to believe that the framework had proven to be more flexible and effective than previous regimes. Because strong inflationary pressures had been kept in check, the MPC had been able to provide substantive monetary policy support to the economy at the onset of the recession, which contrasted with previous recessionary episodes. And this approach had accommodated 'quantitative easing'.

The outlook, as portrayed in the *May Inflation Report*, was for the economy to move back to positive growth over the forthcoming year or so. But the downside risks to output were significant, particularly those associated with the state of the impaired banking system and its impact on the economy's potential growth rate.

#### Meeting the challenges of economic recovery

Andrew Sentance, Monetary Policy Committee member, June 2009.

[www.bankofengland.co.uk/publications/speeches/2009/speech392.pdf](http://www.bankofengland.co.uk/publications/speeches/2009/speech392.pdf)

In this speech, Andrew Sentance outlined how difficulties in the banking system, a required rebalancing of the economy and higher global volatility were likely to act as challenges to the recovery of the UK economy. He described how there were likely to be constraints on lending as banks sought to rebuild their financial reserves. The economy would need to rebalance away from the primary sources of growth over the past decade — consumer spending and financial and business services —

meaning recovery would depend more on overseas demand and the growth of investment. And such a recovery was likely to take place against a background of continued global volatility. But he explained how fundamental changes in the UK economy over recent decades should underpin longer-term confidence for the future. The environment of low and stable inflation, a more flexible labour market and a productive and competitive base of manufacturing and international trading businesses should serve the economy in good stead over the course of the recovery.

#### The state of the markets: four issues

Paul Tucker, Deputy Governor, June 2009.

[www.bankofengland.co.uk/publications/speeches/2009/speech391.pdf](http://www.bankofengland.co.uk/publications/speeches/2009/speech391.pdf)

In this speech, Paul Tucker remarked on four broadly linked issues.

On the macroeconomic outlook and bank lending he said the medium-term outlook remains 'highly uncertain'. He noted that for the moment it is unclear as to whether the financial system can generate the expansion of credit that will most likely be necessary to support recovery. He warned against the risks of banks simultaneously deleveraging by cutting back on the availability of credit, pointing out that this would be a 'counter productive business and financial strategy'.

On the Bank's policy response to the crisis, he discussed quantitative easing and its interaction with the insurance industry and other long-term investment institutions. On trade and working capital finance, he welcomed the recent initiative by the insurance industry to release a code of conduct for trade-credit insurance.

On developing more resilient capital markets he noted that entrepreneurial innovation in capital markets may have outstripped the supporting market infrastructure. In particular he said that the Bank of England agreed that more of the vanilla OTC markets should be cleared via central counterparty clearing houses. He went on to say that the financial community must also be open to more trading in core vanilla markets going via exchanges or other well-designed and open trading platforms, to help preserve liquidity when times are tough. Indeed serious consideration is needed of whether the corporate bond markets could benefit from exchange trading.

Finally, on bank capital instruments, he argued that only equity should count as regulatory capital for banks in the medium term; and called for investors to consider exchanging subordinated debt for equity or senior unsecured debt, as has already occurred in some cases.