# Bank of England speeches

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

## 2009: a review of the economic year

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

www.bankofengland.co.uk/publications/speeches/2009/speech416.pdf

In this speech, Spencer Dale noted that much of the world started 2009 in economic freefall. This was driven by tight credit conditions, amplified by a collapse in confidence. It fell to policy to break the ensuing vicious cycle. In the United Kingdom, the MPC cut Bank Rate to 0.5% and commenced a programme of asset purchases. This easing occurred alongside a range of Government policies. There were encouraging signs that these policies were working; corporate insolvencies and unemployment had both increased by less than might have been feared. Turning to the prospects for 2010: a period of renewed expansion was likely, but this should not obscure the fact that structural adjustments needed to occur in the economy. Explaining his vote to maintain the level of asset purchases at £175 billion in November, he fully recognised the benefits of a more expansionary policy given the downside risks to the economy. However he was also wary of the potential risks to such a policy.

## Finding the right tool for dealing with asset price booms

Adam Posen, Monetary Policy Committee member, December 2009.

www.bankofengland.co.uk/publications/speeches/2009/speech415.pdf

In this speech, Dr Adam Posen discussed how costly asset price booms may be tackled in the future. He rejected the notion that monetary policy can be used to successfully 'lean against the wind' and tackle asset prices directly as he presented evidence that suggested there was no dependable relationship between interest rates, or narrow money, and asset prices. There is also little evidence that tightening of conditions could limit or counteract the boom once under way. In fact, tightening conditions in the face of an asset price boom could make matters worse for open economies through the attraction of capital inflows. Dr Posen highlighted that there are other tools that are better suited to dealing with asset price booms. Macroprudential instruments, such as those proposed in a recent Bank of England (2009) discussion paper would be a welcome addition to the toolkit, given that historically the worst financial crises have come when asset price busts have led to banking system failures. However, there remains room for tools that could directly address costly asset price booms. In presenting evidence that residential real estate bubbles tend to have higher real economic costs than equity booms, Dr Posen suggested that the use of countercyclical real estate taxes could provide the simple blunt instrument required to successfully lean against the wind in real estate prices. The bottom line for monetary policy coming out of the crisis is, if you have a financial problem, use financial policy tools to fix it.

## The UK bank resolution regime

Andrew Bailey, Executive Director for Banking Services and Chief Cashier, November 2009.

www.bankofengland.co.uk/publications/speeches/2009/speech414.pdf

In this speech, Andrew Bailey described the new special resolution regime (SRR), created under the 2009 Banking Act. Having set out the case for an SRR, he described the objectives of the UK regime, the tools available, the roles of the different authorities and the safeguards that exist to protect property rights.

Bailey went on to highlight several areas where further work was required to hone the regime. The Financial Services Compensation Scheme should gradually be pre-funded by industry contributions. On safeguards, the right balance should be struck between discretion and ensuring banks and markets knew as much as they could about how the Bank would, and would not, act in a resolution. Noting that resolution is an invasive form of surgery requiring large amounts of information, he welcomed work on recovery and resolution plans. Finally he noted the importance of ensuring the regime could deal with cross-border resolutions.

## The Bank of England's balance sheet: monetary policy and liquidity provision during the financial crisis

Paul Fisher, Executive Director for Markets, November 2009.

www.bankofengland.co.uk/publications/speeches/2009/speech413.pdf

The extent of the Bank of England's support for the economy during the past two years has been historically exceptional. In this speech, Paul Fisher used the Bank's balance sheet as a framework to describe the expanded set of operations which have been undertaken during the financial crisis. There has been an unprecedented pace of innovation. New tools and facilities, such as the Asset Purchase Facility have been created to implement monetary policy. Other operations, such as the Special Liquidity Scheme, have been focused toward providing liquidity support to the banking system. The Discount Window Facility has been one of the most significant, permanent developments in this framework. He noted that at some point the Bank's balance sheet may return to something like its former composition, and perhaps even its former size, but the innovations introduced during the crisis should leave the Bank better prepared to deal with stresses in the future.

### Recovery and resolution plans

Andrew Bailey, Executive Director for Banking Services and Chief Cashier, November 2009.

www.bankofengland.co.uk/publications/speeches/2009/speech412.pdf

In remarks at the Santander International Banking Conference, Andrew Bailey discussed the role of recovery and resolution plans (RRPs) as part of the response to the banking crisis.

He noted that RRPs should be critical tools for financial institutions themselves (where they should be owned at Board level), banking supervisors and resolution authorities. Bailey stressed that the Bank, in its role as resolution authority, would place great emphasis on the existence of credible and usable resolution plans. He noted that while these must be owned and produced by the authorities, firms would need to play a vital role in producing and maintaining the information needed to enable a resolution plan to be enacted. Bailey went on to use the examples of Northern Rock and Lehman Brothers to illustrate the role that RRPs might play as a device to enable tough questioning on structures and business models.

### Prospects for the British economy after the financial storm

Andrew Sentance, Monetary Policy Committee member, November 2009.

www.bankofengland.co.uk/publications/speeches/2009/speech411.pdf

In this speech, Andrew Sentance discussed the prospects for Britain's economic recovery in the wake of the financial storm. He talked about the positive prospects for UK growth in the short term, including signs of growth across the global economy; positive news from business surveys; improvements in consumer spending and confidence; and an apparent levelling off in unemployment. But he cautioned that there are a number of uncertainties that stand to affect how the recovery develops. The pace of the global recovery and the need for domestic rebalancing between the public and private sector are two particular areas for concern. The legacy of the financial crisis would also create headwinds. But he drew comfort from the resilience of emerging economies and the 1990s' experience in the United Kingdom when a successful rebalancing was achieved. He then went on to discuss the policy choices that will need to be made as the recovery develops to ensure the economy is steered through an upswing underpinned by low inflation.

### The crisis management menu

Paul Tucker, Deputy Governor, November 2009.

www.bankofengland.co.uk/publications/speeches/2009/speech410.pdf

In this speech, Paul Tucker reviewed the various components of a crisis management package for financial institutions. These are central bank liquidity insurance for viable firms and markets; recovery and resolution plans, or 'living wills' for firms; and official sector support operations, including capital of last resort. During the crisis governments have gone beyond insuring retail deposits via established schemes, to guarantee uninsured wholesale creditors too. Principles need to be developed to ensure that the cost falls to firms, their wholesale creditors and equity holders, rather than the general taxpayer.

### Banking on the state

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

www.bankofengland.co.uk/publications/speeches/2009/speech409.pdf

This paper discusses the evolution in the risks to banks' balance sheets and the impact on the evolution of the three elements of the banking safety net — liquidity insurance, deposit insurance and capital insurance. Evidence shows a progressive rise in banking risk that has been accompanied by a widening and deepening of the safety net. The paper then goes on to explain the sources of this time-consistency problem and approaches to tackling it, including introducing leverage limits, reconsidering the industrial organisation of banking and redesigning the safety net.

### Getting credit flowing: a non-monetarist approach to quantitative easing

Adam Posen, Monetary Policy Committee member, October 2009.

www.bankofengland.co.uk/publications/speeches/2009/speech408.pdf

In this speech, Dr Adam Posen argued that unconventional monetary policy should be thought about in terms of its impact on specific credit markets as well as in its general impact on portfolios. The goal of central bank measures was ultimately to turn around the economy, but the proximate target was to restore normalcy to credit markets through aggressive intervention. They were not just measures to expand the money supply *per se*, nor should they be thought of as optimal policy-setting exercises given uncertainty over the size and timing of the impact of quantitative easing. Dr Posen presented international evidence that leads to the conclusion that quantitative easing by the Bank of England will not lead to unacceptably high inflation at any time horizon. However, Dr Posen highlighted an area of concern for policymakers; that the current concentrated structure of the UK financial system may limit the availability of funding for smaller companies and so may constrain the private sector led recovery. In this specific regard, unlike the macropolicy response, the United Kingdom has an uncomfortable parallel with Japan's situation in the 1990s. It is a challenge to policymakers for the United Kingdom to come out of the crisis with a better financial structure that can keep credit flowing than it had going in.

### The debate on financial system resilience: macroprudential instruments

Paul Tucker, Deputy Governor, October 2009.

www.bankofengland.co.uk/publications/speeches/2009/speech407.pdf

In this speech, Paul Tucker summarised the Bank of England's developing thinking on possible macroprudential instruments, designed to help make the financial system more resilient to swings in the credit cycle. There are at least four dimensions to be considered. First, the objective. The Bank doubts that it is feasible to target asset prices or credit growth as such. Instead, the focus could be on the dynamic resilience of the banking system, which could indirectly have a material effect on domestic credit-supply conditions. Second, instruments. They could involve using microregulatory requirements on capital and liquidity for macro, system-wide ends. Sometimes overly exuberant credit expansion affects particular sectors rather than the economy as a whole. So Tucker airs the possibility of sometimes adjusting capital (or liquidity) requirements for lending to specific sectors. Variations of collateral haircuts might also be deployed for secured lending. Third, rules or discretion? Given that simple rules have not been developed for monetary policy, Tucker doubts that a rules-based approach would suffice for macroprudential policy. But to the extent that judgement and discretion were involved, they would need to be constrained by a clear mandate and transparency involving explanations of policy decisions. Fourth, whether international co-ordination is needed, given that domestic residents and firms can always borrow from abroad. Tucker suggests that increasing the capital (and liquidity) requirements of domestic banks would at least enhance their resilience, and so their ability to lend to the real economy when a bubble bursts. Transparency and exchanges of information among authorities might also encourage overseas authorities to apply similar tools. International co-operation would be highly desirable. Concluding, Tucker said that the Bank would issue a Discussion Paper over the subsequent weeks.

### Speech by Mervyn King

Mervyn King, Governor, October 2009.

www.bankofengland.co.uk/publications/speeches/2009/speech406.pdf

In this speech, the Governor set out two key underlying causes of the financial crisis that had engulfed the world economy over the past year: global imbalances; and deficiencies in the structure and regulation of the financial sector. In this speech, the Governor majored on the latter factor.

He highlighted that at the heart of the problem of managing and regulating the financial system is the 'too important to fail' problem — that some banks' incentives are distorted by the knowledge that in a crisis, the government would stand behind them. He set out two possible approaches to dealing with this issue, and called for a debate about how they might be used. One is to try to ensure that the probability of those institutions failing, and hence of the need for taxpayer support, is extremely low. The other is to find a way that institutions can fail without imposing unacceptable costs on the rest of society.

The authorities could set out to achieve the first approach through better regulation — for example through higher capital requirements. This might be complemented by a requirement to have additional contingent capital available when capital gets eroded. But any given capital requirement can never be enough to ensure the stability of an institution with certainty — and a higher capital requirement would always be safer. And through a highly connected financial system, the failure of an important institution would always have the potential to infect the essential — or utility — services banks provide to the real economy.

The alternative is to change the structure of the industry so that the utility services are insulated from the other activities of financial companies, and to restrict public support to these utility providers. But this does not resolve all misaligned incentives. The fundamental issue is that when private companies, outside of the utility sector, engage in a high degree of maturity transformation on a scale that could have consequences for the rest of the economy, the government would not want to stand aside when such an entity fails.

The Governor concluded that there are no easy answers, but the two approaches he outlined could be used in a complementary way.

### Quantitative easing: an interim report

Charles Bean, Deputy Governor, October 2009.

www.bankofengland.co.uk/publications/speeches/2009/speech405.pdf

In this speech, Charles Bean described the operations of the Bank of England's Asset Purchase Facility (APF) and the associated policy of quantitative easing (QE). He discussed the mechanics of QE and explained why purchasing assets through the issuance of central bank reserves necessarily increased the aggregate claims of the banking system on the Bank of England. Consequently it was invalid to conclude that banks were 'sitting on the reserves' rather than lending them out simply because the level of bank reserves had risen. He went on to discuss recent movements in a number of indicators that were consistent with the expected impact from QE, although he noted that it would always be uncertain how successful the policy had been because one can never know what would have happened in its absence. He concluded by noting that the accounting gains or losses on the APF provided an incomplete picture of the impact of QE on the public finances, which should include the higher tax revenues and lower benefit payments which result from stronger nominal output growth, as well as the lower public debt servicing costs incurred during the period of operation of the policy.

### Money, banks and quantitative easing

David Miles, Monetary Policy Committee member, September 2009.

www.bankofengland.co.uk/publications/speeches/2009/speech404.pdf

In this speech, David Miles discussed monetary policy in the context of a weakened financial sector. On the eve of the crisis banks had too little capital and too few highly liquid assets; they had been reliant on short-term funding and acquired assets with inadequate compensation for risk. Cuts in Bank Rate and quantitative easing (QE) smoothed the adjustment of the economy towards more sustainable pricing and availability of credit. These policies aimed to stimulate nominal demand so CPI inflation remained close to target. Further, QE helped engineer the transition to a more stable long run and mitigated the risks of a prolonged recession.

There was no money supply target by which to judge the efficacy of QE. Movements in broad money were neither necessary nor sufficient for QE to influence nominal demand. Asset purchases had led to portfolio rebalancing effects, evident in falling gilt-OIS and corporate bond spreads and stimulating rising equity and corporate bond issuance. Such issuance had helped companies to switch away from bank finance. In the absence of QE companies might have reduced spending by even more in order to repay bank debt. As banks had built up reserves they had become less reliant on short-term and wholesale funding, and the cost of such funding had fallen sharply.

David Miles concluded that it was difficult to be precise about the impact of QE on the economy but that there were clear signs QE was offsetting the impact of the reduced availability of bank credit.

### Separating fact from fiction: household balance sheets and the economic outlook

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

www.bankofengland.co.uk/publications/speeches/2009/speech403.pdf

In this speech, Spencer Dale noted that in order to meet the inflation target a sustained period of robust growth would be required. A key influence on growth would be the extent to which households would need to rebuild their balance sheets. Despite the common presumption, there was little evidence of a debt-fuelled consumption boom. The big increase in household debt was not a myth, but these debts were mostly accumulated to pay for housing. There had been a huge redistribution of wealth between different households. Standard measures of household balance sheets suffered from a 'missing' asset — human capital — and a 'missing' liability — future housing costs. If these were not taken into account, the pressure on households to repair their balance sheets might be exaggerated. Explaining his decision to vote for £175 billion of asset purchases in August, he had thought this would best balance two considerable risks, doing too much versus doing too little.

### Monetary policy and debt sustainability

Kate Barker, Monetary Policy Committee member, September 2009.

www.bankofengland.co.uk/publications/speeches/2009/speech402.pdf

In this speech, Kate Barker considered the questions of debt sustainability and the monetary policy implications of possible balance sheet adjustments. She argued that although debt levels had increased prior to the crisis, debt for many households and most firms was not unsustainable in the sense that there was little chance of repayments being possible. But the expectations of income growth and credit conditions on which debt had been taken on were now unlikely to be realised, leading some to retrench.

With the fiscal plans implying retrenchment by the public sector also, Ms Barker argued that too rapid an adjustment of private sector balance sheets would imply a large improvement in the current account deficit, probably only achievable with below-trend import growth (implying low domestic demand growth). In these circumstances, the rate of inflation would likely remain below target. To avoid this outcome, two conditions were needed. First, banks needed to be put in a position where they were able to lend enough to support economic growth. Second, monetary policy should continue to be set to support lending and borrowing.

### Energy and environmental challenges in the new global economy

Andrew Sentance, Monetary Policy Committee member, September 2009.

www.bankofengland.co.uk/publications/speeches/2009/speech401.pdf

In this speech, Andrew Sentance discussed how increased interdependencies and global spillovers associated with a more integrated global economy present new challenges to policymakers. Increased vulnerability to global shocks and a change in growth and inflation dynamics were likely to have a significant impact on the future path of national economies. He argued that although these changes would likely persist in the future it was important to avoid a retreat into protectionism, promoting instead the need for effective international policy co-ordination across a range of areas including energy and environmental issues. He also argued that we should not expect a return to the apparent 'great stability' and should recognise the global economy as an important source of volatility for economic growth and inflation at the national level going forward.

### Credit is trust

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

www.bankofengland.co.uk/publications/speeches/2009/speech400.pdf

In this speech, Andrew Haldane discussed how the financial crisis was caused by a break down of trust within the banking sector, which through a collapse in confidence led to a withdrawal of credit to the real economy. He assessed the implications of this for three aspects of the financial system: structure, where there may be a case for local relationship-based, as well as global, banking; strategy, where diversity, not diversification, can provide benefits to system stability; and governance, where the alignment of stakeholder incentives with the public good can help ensure the risk of banking activities is better-matched with the possible return. These principles, which were missing in the run-up to the present crisis, can help in building a more stable financial system for the future.