Bank of England speeches

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

The realities and relevance of Japan's Great Recession — neither *Ran* nor *Rashomon*

Adam Posen, Monetary Policy Committee member, May 2010.

www.bankofengland.co.uk/publications/speeches/2010/speech434.pdf

In this speech, Dr Adam Posen assessed the relevance of Japan's Great Recession in offering parallels to today's economic challenges. He noted that Japanese growth was far from flat following the bursting of Japanese bubbles in 1992, but policy mistakes prevented sustainable recoveries taking hold until policies were reversed in the early 2000s. More puzzling is the persistent experience of non-accelerating price deflation. While the United Kingdom is at low risk of suffering such policy-induced recurrent recessions, Dr Posen suggested that deflation could not be ruled out. The United Kingdom combines financial parallels to Japan with far less room for fiscal action to compensate for them than Japan had. Further, Japan had an advantage in its recovery that the United Kingdom and other economies do not share at present, in the availability of growing export markets. Another parallel is the existence of corporate sector surpluses; but, while Japanese corporates sat on their cash, greater openness of the UK corporate sector could allow corporates to invest abroad with returns feeding consumption and productivity growth.

The $100 billion question

Andrew Haldane, Executive Director for Financial Stability, March 2010.

www.bankofengland.co.uk/publications/speeches/2010/speech433.pdf

In this speech, Andrew Haldane discussed the costs and benefits of structural reform to the banking system. In order to regulate banks to reflect the costs of the crisis, a measure of banks' contribution to systemic risk is needed. Estimates based on output foregone or implicit subsidies are large and mainly accounted for by institutions perceived as being 'too big to fail'. The public policy response to date has focused on the role of prudential regulation. As an alternative, Andrew considered the benefits of prohibition for financial system resilience (in terms of modularity, robustness and incentives) and the costs of prohibition (in terms of economies of scale and scope that might be lost as a result of restricting bank functions). The costs appear to be exhausted at fairly modest ranges of banking assets and activities.

Uncertainty in macroeconomic policy making: art or science?

Mervyn King, Governor, March 2010.

www.bankofengland.co.uk/publications/speeches/2010/speech432.pdf

In this speech, the Governor compared and contrasted the treatment of uncertainty and forecasting in economic policy making and in the physical sciences.

In both areas, unpredictability comes from the difficulty of assigning probabilities to infrequent, high-impact events; differences in starting points, even small ones; and sudden transitions in the state of the world. But the Governor noted that it is often possible to identify vulnerabilities and that a system can be made more robust to shocks.

However, one key difference between economics and physical sciences is the presence, in economics, of active decision-makers that affect outcomes. This substantially complicates the dynamics of an economic system. An understanding of decision-making behaviour, and its interaction with policy, is vital. The Governor drew out several influences on individuals' decisions under uncertainty: people are influenced by experience, decisions may be affected by the way information is presented, people tend to follow the actions of others and they often have excessive faith in their own judgements.

Behaviour under uncertainty has implications for policy. In particular, it emphasises the importance of communication. Much of the value of forecasts is in their being understood. An optimal policy balances how much information to communicate and in what form. Communication is an important part of establishing credibility. The Governor went on to explain that it is the whole distribution of outcomes that matters for both understanding and policymaking. He noted that, with this in mind, the MPC's methods of communicating about an uncertain future had evolved and would continue to do so. And he concluded the speech by illustrating some of the practical devices the MPC had used, and were considering using, in communicating about the outlook.

Resolution of large and complex financial institutions: the big issues

Paul Tucker, Deputy Governor, March 2010.

www.bankofengland.co.uk/publications/speeches/2010/speech431.pdf

In this speech, Paul Tucker — Deputy Governor for Financial Stability and chair of the Financial Stability Board's Working

Group on Cross-Border Crisis Management — discussed issues around resolving large, complex financial institutions in an orderly way without injecting public money.

Drawing on the international debate, he considered the two biggest issues that effective resolution regimes will have to address. First, whether there should be the ability to make adjustments to unsecured creditors' claims in the form of haircuts and/or equity conversions in a going concern, rather than incurring large losses as creditors in a gone concern bank insolvency process. Such an approach would in effect combine features of standard regimes for resolving commercial banks (rapidity, public policy objectives) with some features of the US Chapter 11 for non-financial companies (haircuts for creditors in a continuing business).

And second, how to address the obstacles to handling the resolution of internationally active institutions and the associated big issues about how insolvency and resolution laws are applied to internationally active financial companies. In particular, the differences between 'territorial' and 'universal' principles governing resolution and a possible intermediate course that could be described as 'modified universalism'. That would be based on a principle of equitable treatment of worldwide creditors which would be consistent with the imposition of losses on unsecured creditors. It might be agreed on a firm-by-firm basis.

In terms of the international debate around Too Big To Fail, this would involve changing our sense of what 'Fail' involves. Perhaps it would not have to involve liquidation or administration. Perhaps it would not have to involve a binary shift from 'going concern' to 'gone concern'. But it would have to involve loss for equity holders and uninsured creditors. It would have to rekindle market discipline. It would have to preserve the flow of financial services. Individual countries or economic areas such as the EU can get only so far on their own. To cope with distress in global banking, the highest reaches of the authorities need to decide whether or not they want international collaboration in the resolution of cross-border banking groups.

Prospects for global economic recovery

Andrew Sentance, Monetary Policy Committee member, March 2010.

www.bankofengland.co.uk/publications/speeches/2010/speech430.pdf

In this speech, Andrew Sentance discussed the prospects for continued global economic recovery. He argued that a bounceback in confidence, strong growth in Asia and other emerging markets and the impact of economic policy stimulus had aided the global recovery so far and this had also supported the recovery in the United Kingdom. But there were several uncertainties affecting the outlook. New shocks, both at home and abroad, could not be ruled out. And major financial and fiscal adjustments were needed in Europe and the United States. But he argued that there were good grounds for expecting the global economic recovery to continue and provide a healthy support to the UK economy in the years ahead. He concluded by explaining that the appropriate degree of policy stimulus would be continually reassessed in light of the progress of the recovery at home and abroad and its impact on inflationary pressure.

The UK economy after the crisis: monetary policy when it is not so NICE

Charles Bean, Deputy Governor, March 2010.

www.bankofengland.co.uk/publications/speeches/2010/speech429.pdf

In this speech, Charles Bean noted a gradual economic recovery had begun but the pace of future growth was uncertain. Downside risks came from the weak banking system, high household indebtedness, the need for fiscal contraction, and growth prospects overseas. But the substantial stimulus from monetary policy, including the MPC's asset purchases, and the depreciation of sterling were working in the other direction. There was uncertainty about the amount of spare capacity and its impact on prices, but he concluded that inflation was likely to return to target in the medium term.

He then noted some criticisms of the monetary policy framework. Policy was unlikely to be different under a 'dual mandate'; raising the inflation target would be unhelpful; and regulatory policies were better suited to preventing financial imbalances. And if monetary policy were used to restrain credit growth, it could be explained within the current mandate.

QE — one year on

Spencer Dale, Executive Director and Chief Economist, March 2010.

www.bankofengland.co.uk/publications/speeches/2010/speech428.pdf

In this speech, Spencer Dale looked back at an extraordinary year for the economy, focusing on the policy of buying assets using the Asset Purchase Facility, known as quantitative easing (QE). Drawing on insights from the academic literature, the MPC placed weight on three key channels through which asset purchases operate: imperfect substitutability and portfolio rebalancing; improvements in financial market liquidity; and expectations. Judging the impact of QE to date was difficult, but event studies suggested that gilt yields may have been reduced by around 100 basis points. Equity and corporate bond prices had increased substantially and the growth of broad money was stronger than it otherwise would have been. Much of the impact of asset purchases to date was still to come through, so it was too early to judge their ultimate impact on nominal spending and inflation. Looking forward, policy decisions would continue to be guided by the outlook for inflation.

Fair value in foul weather

Andrew Haldane, Executive Director for Financial Stability, March 2010.

www.bankofengland.co.uk/publications/speeches/2010/speech427.pdf

In this paper, Andrew Haldane discussed the history of accountancy and valuation and how the recent crisis has renewed the debate around the use of fair value. At the heart of this is the question of whether the Efficient Markets Hypothesis holds and whether market prices are a full and fair reflection of the present value of future cash flows on an asset. In practice, particularly during times of crisis, evidence suggests they may not be. Against this background, Andrew discussed the main arguments for and against the use of marking to market and proposed some broad principles which could help frame accounting standards: (1) the importance of a common measuring rod; (2) a failure of efficient markets is not of itself a failure of fair value; (3) better accounting for expected losses; and (4) business models matter, especially for banks.

Monetary policy — from stability to financial crisis and back?

Kate Barker, Monetary Policy Committee member, March 2010.

www.bankofengland.co.uk/publications/speeches/2010/speech426.pdf

In her final speech as an MPC member, Kate Barker sought to draw lessons from her experience, and suggested some changes in the approach to policy.

She noted that there was much uncertainty about the present size of the output gap, partly as it was not easy to reconcile a large negative output gap with recent upward surprises on inflation. One proposal for the future might be that the MPC could consider using a range of different plausible estimates of the output gap and its effect on inflation as part of the methodology for constructing the growth and inflation fan charts.

She also considered whether it might be useful to reconsider the merits of looking to inflation prospects beyond the normal forecast horizon, to ensure any future risks to economic stability are taken into account. With the benefit of hindsight, this might have been helpful in the period before the financial crisis.