Bank of England speeches

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

Patience and finance

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

www.bankofengland.co.uk/publications/speeches/2010/speech445.pdf

Andrew Haldane discussed the roles of patience and impatience in financial decision-making, drawing on lessons from economics, history, psychology and neurology. Andrew considered how these two traits have evolved and influenced the financial system. There is ample evidence of self-improving financial cycles, with China being one example. But the United States and United Kingdom have shown increasing excess volatility and misalignment in asset markets, consistent with a self-destructive cycle of increasing impatience. Falling average holding periods of assets, high dividend payout ratios and high implied discount rates for assets are also consistent with increasing impatience. In terms of potential public policy implications, countries embarking on financial liberalisation need to walk a fine line between increased saving, investment and growth, and increased volatility and consumption, which calls for careful sequencing of financial reform. Providing incentives for longer duration of asset holdings and promoting financial pre-commitment devices such as trust and pension funds may also help curb impatience.

Monetary policy after the fall

Charles Bean, Deputy Governor, August 2010.

www.bankofengland.co.uk/publications/speeches/2010/speech444.pdf

In this paper presented to the Federal Reserve Bank of Kansas City Economic Symposium in Jackson Hole, Deputy Governor Charles Bean drew some lessons from the crisis for the future conduct of monetary policy. He provided evidence that relatively low policy rates, in the United States especially, contributed modestly to the rapid growth in credit and house prices during the run-up to the crisis, and that the Great Moderation also appeared to have played a part. In both the United States and the United Kingdom, unconventional monetary policies in the form of large-scale asset purchases appeared to have met with some success in lowering longer-term yields, but he argued that it would be better to return to relying on a short-term interest rate once normal times return. He found unconvincing the argument that the target inflation rate should be increased so as to provide more room for manoeuvre, while evidence suggested that the gains from moving to price-level targeting were likely to be modest. While the case for 'leaning against the wind' (raising policy rates higher than required to meet immediate inflation objectives in order to cool a credit/asset price boom) was stronger in the light of the crisis, the collateral damage to output from a policy sufficiently aggressive to make enough of a difference was likely to be high. He concluded that deployment of a macroprudential policy toolkit focused more closely on the underlying source of credit market exuberance was more promising.

Monetary policy and financial stability

David Miles, Monetary Policy Committee member, July 2010.

www.bankofengland.co.uk/publications/speeches/2010/speech443.pdf

In this speech, Professor David Miles discussed recent developments in monetary policy and argued that there are better tools than interest rates to achieve financial stability. Given that the rapid expansion in banks' balance sheets coincided with a period of historically low levels of interest rates, some have argued that monetary policy should be used to reduce the chances of banking crises in the future. Professor Miles suggested that higher capital requirements bring great economic benefit via a reduction in the probability of financial crises. Meanwhile, he found little theoretical or empirical evidence suggesting that higher capital requirements would be associated with a significant loss of output. He argued that the fragility of the banking system can be significantly reduced without incurring a large cost. Using capital requirements to help maintain financial stability and monetary policy to help maintain price stability is an efficient allocation of instruments to goals.

The contribution of the financial sector — miracle or mirage?

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

www.bankofengland.co.uk/publications/speeches/2010/speech442.pdf

In this speech, Andrew Haldane discussed the importance of understanding and measuring the contribution made by the financial sector to economic well-being. The contribution of the financial sector over time can be gauged from the national accounts. But the measures do not adjust for risk, which is key for a sector such as banking. Adjusting for risk would better capture the contribution of the financial sector to the economy. But even then, this would still provide no assessment of the ability of the financial system to price risk correctly. Strategies such as leveraging up of the underlying equity in the business and increasing assets held at fair value may have disguised the risks that banks assumed in their hunt for yield ahead of the crisis. Better aggregate statistics and bank-specific performance measures could help mitigate such risk illusion and distinguish productivity miracles and mirages.

The financial crisis reform agenda

Andrew Bailey, Executive Director for Banking Services and Chief Cashier, July 2010.

www.bankofengland.co.uk/publications/speeches/2010/speech441.pdf

In this speech, Andrew Bailey discussed the recently announced proposals to change the arrangements for financial regulation in the United Kingdom, and the future resolution of problems in large banks.

Andrew reviewed the role of the Bank as prudential supervisor of banks pre-1997. Andrew emphasised that in its new role as a prudential regulator the Bank will focus in judging and dealing with the build-up of excessive risk in the financial system. This approach will require the exercise of skilled judgement and the ability to use that judgement to influence management and boards.

On resolution, Andrew emphasised that banks should not operate on the basis of a dependency on public money if they get into trouble. Moreover, it was a mistake to allow capital instruments for banks that do not absorb losses unless the bank enters an insolvency process. An alternative worth exploring, drawing on the tools used to restructure non-banks, is creditor recapitalisation or 'bail-in'. Such an approach could incentivise banks to hold larger loss-bearing capital buffers to insulate creditors.

UK monetary policy — how long should 'the song remain the same'?

Andrew Sentance, Monetary Policy Committee member, July 2010.

www.bankofengland.co.uk/publications/speeches/2010/speech440.pdf

In this speech, Andrew Sentance discussed his views on economic prospects and outlined his current policy thinking, having voted for a rise in interest rates at the June meeting of the MPC. He argued that the current economic situation was very different from the outlook facing the MPC when the current policy stance was put in place. The global economy had bounced back strongly, money spending was rising healthily in the United Kingdom, business surveys were generally positive and inflation had been running above target. He suggested that the absence of large margins of spare capacity together with the depreciation of sterling could help explain why inflation had not fallen back as expected by the MPC a year ago. To keep monetary policy in tune with these developments, there should be a gradual rise in interest rates as recovery progressed.

The British recovery in international comparison

Adam Posen, Monetary Policy Committee member, June 2010.

www.bankofengland.co.uk/publications/speeches/2010/speech439.pdf

In this speech, Dr Adam Posen offered his views on UK economic recovery in a comparative context. He noted that the impact of the negative shock that hit the UK economy was not very different from that which hit similar economies and, with the exception of the United States, the subsequent recovery has also not been too dissimilar. Where the United Kingdom stands out is in experiencing rising inflation despite deflationary pressures. Dr Posen argued that it is difficult to attribute the rise in inflation in the United Kingdom solely to 'one-off' relative price shocks. Instead, he considered the possibility that the persistent overshooting of the inflation target over the past few years may have resulted in an upward creep in the public's inflation expectations. In his view, the overshooting of the inflation target is a result of the stance of monetary policy having been appropriately set to prevent a terrible downside risk such that it appears too loose if the risk does not materialise. He argued that the UK economy is tentatively in the state of recovery, but still subject to significant downside risks.

Why is CPI inflation so high?

Paul Fisher, Executive Director for Markets, June 2010.

www.bankofengland.co.uk/publications/speeches/2010/speech438.pdf

Paul Fisher described two sets of factors that pushed inflation above target and set out his views on the appropriate monetary policy response. First, the downwards pressure on inflation from the recession did not appear to be as strong as it might have been. That was evident from the business surveys, which suggested the degree of spare capacity in firms was rather less than implied by the fall in output. Second, there had been a series of shocks to relative prices (from changes to the VAT rate, higher oil prices and a falling exchange rate) which combined to put temporary upwards pressure on inflation. Given the expected degree of spare capacity in the economy, and as the temporary factors boosting inflation wore off, it was most likely that inflation would fall back to below target. It was therefore not sensible to offset the recent rise in inflation by tightening policy.

The Governor's speech at the Mansion House

Mervyn King, Governor, June 2010.

www.bankofengland.co.uk/publications/speeches/2010/speech437.pdf

In this speech, the Governor outlined the Bank's priorities for monetary and financial stability. For monetary stability, he said that the priority remained keeping inflation low and stable. Although for the past three years inflation had been volatile, and for much of the time above the 2% target, this could be more than accounted for by sharp changes in oil prices, VAT and the impact of sterling's depreciation. These factors had clearly led to higher inflation for a period, but, by themselves would not lead to persistent inflation. Indeed, as the fall in demand had created a significant margin of spare capacity in the economy, there was a significant risk that inflation would be dragged below the 2% target in the medium term. But there were also upside risks — especially if the period of above-target inflation led to a de-anchoring of inflation expectations. The Governor stressed that no one should doubt the determination of the Monetary Policy Committee to meet its target and it would not hesitate to withdraw stimulus when it judged necessary.

The priority for financial stability was accepting the new responsibilities announced by the Chancellor — operation of microprudential banking regulation via a new subsidiary of the Bank and macroprudential policy to mitigate risks within the financial system as a whole. The Governor highlighted two lessons from the financial crisis. First, that putting prudential regulation into the same organisation as the oversight of consumer protection and market control did not work in practice. Separating them was the right direction of reform. A second lesson was that, in a crisis, the Bank could not effectively perform its role as lender of last resort without first-hand knowledge of the health of the banks to which it might need to provide support.

The Governor explained that the Bank would bring a new culture to regulation, avoiding overly legalistic regulation and using judgement and discretion to maintain financial stability of the banking system as a whole. Banks would face bottom-up institution-specific capital requirements, as well as system-wide policy measures that would vary over the economic cycle. A new Financial Policy Committee would make judgements on system-wide instruments.

The Governor ended by noting that it was absolutely necessary to have a framework for both monetary stability and financial stability. One without the other was not enough.

When central banks buy bonds — independence and the power to say no

Adam Posen, Monetary Policy Committee member, June 2010.

www.bankofengland.co.uk/publications/speeches/2010/speech436.pdf

In these comments, Dr Posen countered those who argue that large-scale purchases of government bonds or private sector securities by central banks compromises their independence from elected officials, their reputation and subsequently their counterinflationary credibility. He highlighted empirical work suggesting the only aspects of central bank independence to matter for inflation outcomes were whether the governor could be fired (without cause) and whether the central bank can be forced to purchase government bonds directly (monetise debt). 'Central bank independence is about the ability to say no to demands for bond purchases when they are economically unjustified, no more, no less.' Excessive worrying about reputations and appearances can be counterproductive. In the current environment, when the nominal interest rate is at or close to zero and the transmission mechanism is damaged, buying bonds is the only means central banks have to counter deflationary pressures. 'Getting unduly caught up in protecting the appearance of central bank independence … will not do any good because it is not that appearance which delivers desirable results … it will prevent pursuing the right policy option.'