# Bank of England speeches

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

## The MPC's policy dilemma

Charles Bean, Deputy Governor, March 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech479.pdf

In a speech to the Association of British Insurers 2011 Economics and Research Conference, Deputy Governor Charles Bean discussed the sources of elevated inflation in the United Kingdom, whether it was likely to persist and the policy response. He opened by discussing the headwinds to demand: the impact of the financial crisis, fiscal consolidation and depressed domestic demand. Charles Bean went on to discuss three factors behind currently above-target inflation: the rise in the price of energy, an increase in non-fuel import costs following sterling's depreciation and the increase in VAT. Monetary policy had accommodated around half of the impact of these inflation shocks. Charles Bean concluded by assessing the outlook for inflation in the medium term. The MPC would need to balance the risk that inflation may prove more persistent than embodied in its latest projections against downside risks to growth that would put downward pressure on inflation.

## Lessons on unconventional monetary policy from the United Kingdom

Charles Bean, Deputy Governor, February 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech478.pdf

In remarks at the US Monetary Policy Forum, Deputy Governor Charles Bean discussed the lessons on unconventional monetary policy from the United Kingdom. Charles Bean noted that, during the crisis, the Bank provided enhanced liquidity support and undertook transactions in corporate assets to improve the operation of temporarily dysfunctional markets. He went on to describe the MPC's outright purchases of longer-dated assets financed by the issuance of reserves. Charles Bean explained that the objective of this policy was to raise the prices of the purchased assets and of substitute assets in order to boost nominal spending through wealth and cost of capital channels. He noted that event studies, and the return of nominal GDP growth to pre-crisis levels, provided supportive evidence of this policy having been successful. However, Charles Bean concluded that central banks should continue to rely on short-term interest rates as their main policy instrument in normal times.

## Discussion of Lord Turner's lecture, 'Reforming finance: are we being radical enough?'

Paul Tucker, Deputy Governor, February 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech477.pdf

In this speech, Paul Tucker commented on the Clare Distinguished Lecture in Economics by Lord Turner, 'Reforming finance: are we being radical enough?'. Mr Tucker reviewed some recent interactions between policy and economic theory, arguing that there needed to be fundamental change in the 'rules of the game' for the financial system. A recent theoretical paper by Shleifer *et al* (2010) shows that moving away from the traditional rational expectations world and introducing myopia about certain low probability, high impact risks can generate the sort of outcomes seen in the recent financial crisis. For example, they show that this sort of myopia can lead to overinvestment in securities that carry those characteristics — in the recent crisis, that could be seen in the ballooning of ABS issuance and the mispricing of those instruments as a result of the search for yield. Such theoretical papers serve as a bridge to policymaking, as they have important macroprudential policy implications.

One policy implication of myopia is that we need to attend to risks beyond the banking sector — in shadow banking, such as money market funds. A second policy implication is that it is vital that (regulatory) capital requirements for banks more or less truly capture their risks. The current Basel work to review fundamentally the capital requirements for banks' trading books will be a key plank of the capital reforms. As will the work on how much greater loss-absorbing capacity — whether in the form of pure equity or contingent capital bonds — should be held by Global Systemically Important Financial Institutions. But higher capital requirements are not sufficient if the incentives that created the Too Big To Fail problem are not addressed. A key element of that is the international work on effective resolution regimes. That means building institutions that underpin the commitment to resolve firms in a way that ensures financial stability, rather than bailing them out.

## Ten good reasons to tighten

Andrew Sentance, Monetary Policy Committee member, February 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech476.pdf

In a speech to the Ashridge Alumni business briefing in London, Dr Andrew Sentance summarised ten arguments for tightening monetary policy at the current economic conjuncture. He began by arguing that monetary policy should lean against the persistently high UK inflation, which is partly caused by global inflationary pressures. Policymakers should also be alert to the risk that strong global and domestic demand is fuelling such pressures, which tighter monetary policy can counterweigh by affecting the value of sterling on foreign exchanges. Turning to the supply side, Dr Sentance pointed out that the perceived margin of spare capacity had yet to put downward pressure on inflation, while companies appear to be more willing and able to pass through cost increases. In light of this evidence, in his view the MPC should take early action to protect its credibility, by gradually raising interest rates from current record low levels.

### Monetary policy in extraordinary times
David Miles, Monetary Policy Committee member, February 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech475.pdf

In this speech, David Miles argued that the recent recession was unprecedented in peacetime. Rebalancing of the economy would require tighter fiscal policy, exports rising by more than imports, and a higher saving rate. This would need to happen while confidence is fragile, unemployment significantly higher than before the recession, and inflation substantially above the 2% target level.

Monetary policy could be set to reduce inflation back to target more rapidly than implied by the central profile in the February *Inflation Report* fan charts. However, that might not be desirable: for example, a substantial appreciation of the exchange rate might add to volatility of output in the short term and be unhelpful for rebalancing; and more slack in the economy could erode productive potential and increase structural unemployment.

Reforms to prudential regulation and the structure of the banking system, in particular increases in banks' capital, would help lower the risk of encountering similar crises in the future.

### The soft tyranny of inflation expectations
Adam Posen, Monetary Policy Committee member, February 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech474.pdf

In this speech, Dr Posen discussed different measures of UK inflation expectations and how monetary policy makers should respond to them. He argued that there is no sign of medium or long-term inflation expectations becoming de-anchored in the data. Surveys of households' and professional forecasters' long-term inflation expectations remain close to their historical averages. Financial market indicators suggest that uncertainty about future inflation has increased, consistent with greater economic uncertainty, but this has not been accompanied by a rise in the level of long-term inflation expectations. Together, this evidence suggests continued confidence in the MPC's commitment to the inflation target. Although some short-run survey measures of household inflation expectations have picked up recently, Dr Posen presented evidence showing that movements in these and related indicators have not tended to feed through to higher wage growth over the past 25 years. He warned that tightening policy pre-emptively, in response to worries about sudden swings in sentiment, would increase the risk of overshooting the inflation target on the downside.

### The United Kingdom's inflation problem: selling England by the pound?
Andrew Sentance, Monetary Policy Committee member, February 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech472.pdf

In a speech to the 'State of the Economy' Conference in London, Dr Andrew Sentance explained why he thought inflationary pressure was greater than suggested by the latest *Inflation Report* forecast and why higher interest rates are now needed. He argued that too much faith was being put on the impact of a large 'output gap' pushing down on inflation, which might not materialise given uncertainty about the degree of spare capacity in the economy, strong domestic demand and a shift in businesses' perception of the pricing climate. He also thought there was not enough weight being placed on the inflationary pressures from the global environment and the past depreciation of sterling. He concluded that while the exchange rate should not become the centrepiece of UK monetary policy, a modest appreciation of sterling would mitigate the impact of global inflationary pressures and help to steer inflation back to the target.

### Speech by the Governor
Mervyn King, Governor, January 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech471.pdf

In this speech, the Governor explained that three factors could account for recent high inflation. Rises in import prices and world energy prices combined with recent increases in VAT have added 12% to the price level over the past four years. The contribution of domestically generated inflation over that period was close to zero, and well below the target.

The Governor noted that the three factors above have led to sharp falls in real wages. But, being a real adjustment there was nothing the MPC could have done to prevent this squeeze in living standards; that is a legacy of the banking crisis and the need to rebalance the economy. Had the MPC raised Bank Rate significantly, the current recession would have been even deeper and this would not have met the MPC's remit to avoid undesirable volatility in output in attempting to meet the inflation target.

### Setting UK monetary policy in a global context
Andrew Sentance, Monetary Policy Committee member, January 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech470.pdf

In a speech to the European Policy Forum in London, Dr Andrew Sentance discussed the global forces that affect UK inflation. He highlighted three channels through which global economic developments affect UK inflation: import prices; demand; and the global pricing climate. He pointed to the trends in emerging and developing economies that appear to have shaped global price developments and capacity pressures recently and their impact on UK inflation. Dr Sentance also stressed that recovery in UK domestic demand was helping to lift the UK economy out of recession. But coupled with a resurgence of global inflationary pressures and the additional inflationary impact from the exchange rate depreciation, this was likely to lead to upward pressure to the business pricing climate and expectations. This provided a strong case for a gradual monetary tightening, as further delay could lead to a much larger tightening in the future, jeopardising the recovery.

### The outlook for financial regulation in the United Kingdom
Andrew Bailey, Executive Director for Banking Services and Chief Cashier, January 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech469.pdf

In this speech on a regional visit to Edinburgh, Andrew Bailey reviewed initiatives to shape the future of financial regulation. Andrew spoke about the difficulties faced by Scottish banks during the financial crisis, and the potential impact of developments in the euro area on UK banks.

Andrew reviewed the changes in the financial system since 2007 and how the Bank and regulators around the world will continue to ensure that financial institutions are taking the necessary steps to move them towards having more robust capital and liquidity buffers.

Andrew used the analogy of the failures of monetary policy in the 1970s to illustrate why it was important that there is a strong understanding in public policy of the need for financial stability. This highlights the need for a clear consensus that financial stability is a goal which will result in a clear improvement to the welfare of the public.

### Global imbalances in retrospect and prospect
Andrew Haldane, Executive Director for Financial Stability, December 2010.

www.bankofengland.co.uk/publications/speeches/2010/speech468.pdf

Andrew Haldane assembled stylised facts from the past on global imbalances, in terms of both the size and direction of these global flows. He then went on to consider potential drivers of these imbalances, focusing on the gross saving and investment behaviour of surplus and deficit countries. Andrew focused on two archetypical surplus and deficit countries — China and the United States — highlighting differences in saving behaviour across sectors, distributions to shareholders and social factors between the two countries. Finally, Andrew considered the likely evolution of global financial integration and differential savings behaviour in order to assess the potential course of imbalances in the future. This implies a potentially dramatic shift in the pattern of global capital flows going forward, with potential pressure for further widening global imbalances and further pressure on international monetary, financial and trading systems.

### The UK inflation outlook if this time isn't different
Adam Posen, Monetary Policy Committee member, December 2010.

www.bankofengland.co.uk/publications/speeches/2010/speech467.pdf

In this speech, Dr Posen discussed the prospects for UK inflation based on past experiences of the United Kingdom and other economies in similar episodes. He argued that this approach to inflation forecasting is superior to one based on extrapolation of recent data which may tempt one to conclude that 'this time is different'. He discussed four empirical regularities based on past experience that are relevant to the current inflation forecast. He argued that the Phillips curve relationship between short-run output/employment and inflation continues to hold and that the output gap that opened up in the wake of the financial crisis is likely to persist for some time, pulling down on inflation. He showed evidence that consumption and inflation tend to fall following episodes of fiscal consolidation and that the declining unit labour costs in the United Kingdom are also likely to be disinflationary.

## The economic outlook for 2011 and beyond

Charles Bean, Deputy Governor, December 2010.

www.bankofengland.co.uk/publications/speeches/2010/speech466.pdf

In a speech to the Market News International Annual Seminar, Deputy Governor Charles Bean discussed economic developments over the past year and the challenges ahead. Charles Bean opened by describing activity indicators as having given some comfort that a recovery was under way. Looking forward, however, he noted that economic prospects would depend on private final demand and net exports increasing. The impact of the prospective fiscal consolidation on consumption remained an open question. Also, given the depreciation of sterling since 2007, the contribution of net exports to the recovery had thus far been somewhat disappointing. Charles Bean noted that inflation had been considerably higher than the MPC had expected. He also noted that strong global growth generated upside risks to inflation through commodities and tradable goods prices. He concluded by saying that it would, at some point, become appropriate to begin withdrawing the current monetary stimulus in a measured fashion.