Bank of England speeches

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

The challenges of the 'New global economy'

Andrew Sentance, Monetary Policy Committee member, May 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech500.pdf

In a speech to the Jersey Chamber of Commerce, Dr Andrew Sentance described the way in which the global economy has become more integrated and the challenges that poses. Four main forces have come together — new technologies, trade liberalisation, political change and market deregulation. This has presented three challenges for policymakers: first, an ongoing process of structural change created by the shift in global economic gravity towards Asia; second, a prolonged period of upward pressure on energy and commodity prices; and third, increased potential for global economic volatility. In the face of these challenges, he argued that monetary policy should continue to be guided by price stability and seek to counteract global inflationary pressures through influencing the exchange rate, the demand climate and price expectations. Continuing to accommodate inflation without adjusting monetary policy poses a threat to the credibility of the monetary policy framework and may damage longer-term economic growth.

The economic outlook: some remarks on monetary policy

Paul Fisher, Executive Director for Markets, May 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech499.pdf

In this speech, Paul Fisher set out his personal views on monetary policy. Over the past couple of years, inflation has been driven higher by changes in VAT, energy and import prices. Given the lags involved in the transmission mechanism and the need for rebalancing, Paul thought that there was little monetary policy should have done to offset these various price-level shocks, although the combination of high inflation and slow growth does pose a significant challenge for policymakers.

Paul then discussed his views on consumer spending, spare capacity and inflation expectations, concluding that the risks to medium-term inflation are broadly balanced around the 2% target. But given his immediate concerns about consumption, he believed that raising Bank Rate could be exactly the wrong thing to do at this precise moment, and that there remains time to allow the economy to recover before the eventual policy normalisation begins.

Building resilient financial systems: macroprudential regimes and securities market regulation

Paul Tucker, Deputy Governor, May 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech498.pdf

In a speech at the International Council of Securities Associations Annual General Meeting, Paul Tucker discussed how the regulation of securities markets fits into the development of macroprudential regimes. He explained how banking and securities markets have become less distinct over recent decades, with implications for both in banking supervision and securities regulation. He discussed whether, from a financial stability perspective, a distinction between 'intra-financial firm markets' and 'end-user markets' might be more useful than the more familiar distinction made by securities regulators between 'public markets' and 'private markets'. He went on to describe various ways in which listing authorities and securities regulators could do more to detect and contain risks to stability.

The economic outlook

Charles Bean, Deputy Governor, May 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech497.pdf

In a speech to the Northern Ireland Chamber of Commerce, Deputy Governor Charles Bean described the economic outlook and changes in the UK economy. He asked whether the recent slowing of growth represented a temporary 'soft patch' or indicated a prolonged period of slower growth. He said that consumer and public spending were likely to remain subdued but that the MPC expected both business investment and net trade to contribute positively to growth over the next few years. He went on to describe the puzzling weakness in productivity growth and the temporary factors which were contributing to the currently elevated level of inflation. Charles Bean concluded by noting that there would likely be a difficult period ahead as living standards adjusted to the impact of substantial shocks to the economy, but that monetary policy, which sought to smooth the adjustment path, would be consistent with the MPC's remit.

The supervisory approach of the Prudential Regulation Authority

Andrew Bailey, Executive Director, Prudential Regulation Authority — Deputy CEO designate, May 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech496.pdf

In this speech, Andrew Bailey set out how the PRA intends to approach supervision of banks and investment firms. He emphasised the PRA's proposed new single statutory objective of promoting financial stability in the United Kingdom and importantly that the PRA will not seek to avoid failure of regulated firms 'at all costs'. He highlighted that the PRA will want to ensure firms carry out their business in a way that minimises any adverse effects on the financial system, including by seeking to ensure that those firms that do fail can be closed in an orderly manner.

Andrew set out some of the PRA's key features, including forward-looking judgement-based supervision, a focus on firm resolvability, a new risk framework assessing risks to financial stability, regular contact with PRA senior management for systemically important firms, high-quality data, purposive rules and a proactive approach to influencing the international debate.

The short long

Andrew Haldane, Executive Director for Financial Stability, May 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech495.pdf

At the 29th SUERF (Société Universitaire Européene de Recherches Financières) Colloquium in Brussels, Andrew Haldane discussed a paper written with Richard Davies on the effects of short-termism in investment decision-making. Mr Haldane began by outlining the existing empirical and quantitative evidence for short-termism, which is broadly consistent with the theory that capital myopia may be rising. He went on to construct a set of quantitative tests to assess the significance and scale of short-termism in equity markets, by examining whether expected future cash flows are discounted excessively in the determination of equity prices today. The empirical tests suggested that there is significant evidence of short-termism over the past few decades across all industrial sectors. Finally, Mr Haldane outlined the implications of this for the real economy, namely that some projects may be rejected because future cash flows are discounted too heavily, reducing investment and growth. Public policy responses to this market failure include greater transparency about long-term performance, improved governance, better contract design and tax or subsidy measures.

Keynote speech to the Building Societies Association Annual Conference

Andrew Bailey, Executive Director, Prudential Regulation Authority — Deputy CEO designate, May 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech494.pdf

In this speech, Andrew Bailey discussed the impact of the crisis on building societies and retail banking more generally and what that means for the future. Andrew began by addressing the issue of promoting diversity in the banking industry and specifically mutuals, saying he is in favour of promoting competition in the banking industry. But he explained that we need to be very careful what we mean by promoting competition and diversity because both need to be sustainable. Andrew went on to discuss competition saying that competition in banking needs careful assessment to understand the nuances. Andrew ended his speech by noting the importance of good risk management systems that help management to understand the risks inherent in their businesses and the need to attract and retain senior management and board members of the right calibre.

Key issues for UK monetary policy

Andrew Sentance, Monetary Policy Committee member, April 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech493.pdf

In a speech in Manchester, Dr Andrew Sentance discussed four key issues that contributed to his difference of view from the majority on the MPC over the past year. First, was the powerful influence of global inflationary pressures, which he expected to be more persistent than the current *Inflation Report* forecast assumed. Second, was the role of sterling in UK monetary policy, which he argued was an important channel through which monetary stimulus transmitted inflationary impetus to the economy. Third, he argued that the relationship between the 'output gap' and inflation was uncertain, and a wide range of evidence suggested little dampening impact on inflation from spare capacity. Fourth, he pointed to the key roles of credibility and inflation expectations in keeping inflation on target over the medium term, highlighting the risk that persistent inflation over-runs without policy reactions could lead to upward drifts in expectations and a loss of credibility.

Macroprudential policy: building financial stability institutions

Paul Tucker, Deputy Governor, April 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech492.pdf

In a speech at the 20th Annual Hyman P Minsky Conference, Paul Tucker discussed the interaction of the United Kingdom's new macroprudential regime with domestic arrangements for microprudential supervision, with monetary policy, and with new international arrangements. He explained that the creation of the Financial Policy Committee (FPC) plugged a gap between microprudential regulation and macroeconomic policy, placing greater emphasis on the resilience of the financial system as a whole. Faultlines would need to be identified across firms, markets and infrastructure. He said it was important that authorities set standards of resilience suited to tail events without impairing the longer-term performance of the economy, and emphasised that policymakers should be able to vary the required level of resilience in light of changing circumstances through the use of cyclical instruments. He also discussed the arrangements for the interim FPC, its objectives, role and scope. He described how its work would fit with that of the Monetary Policy Committee.

Central bank policy on collateral

Paul Fisher, Executive Director for Markets, April 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech491.pdf

During the financial crisis, the Bank massively expanded the scale of its operations to provide liquidity to the banking system. That expansion prompted new and difficult questions about the range of securities the Bank would accept as eligible collateral. In his speech Paul Fisher set out some of the Bank's thinking on its collateral policy, including a number of high-level principles and a set of associated questions relating to eligibility, valuation, haircuts and limits. Paul also explained how the Bank's operations vary in their policy objectives and so have different eligible collateral pools that are tailored to match the policy goals of the different operations. He then moved on to explain recently announced changes to the eligibility of a number of sovereign and supranational issuers whose debt has moved from the narrow to the wider collateral set.

Japan can — and will — be a normal economy again

Adam Posen, Monetary Policy Committee member, April 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech490.pdf

In the speech at the 12th Annual Mitsui Symposium at Columbia University, Dr Posen argued that the view of the Japanese economy as atypical and not subject to standard economic analysis is unfounded. He argued that in the absence of macroeconomic policy mistakes, and following a temporary growth surge driven by the rebuilding from the earthquake and tsunami, the Japanese economy should grow over time at approximately the rate of productivity growth — around 2% annually — adjusted for changes in prices and population size. He noted that despite the high level of outstanding public debt, net debt is actually much lower than gross debt and public indebtedness to foreigners remains insignificant. This suggests that fiscal policy need not be a significant constraint on the short-term rebuilding nor long-term growth. And he argued that the current recovery and the inevitable depreciation of the yen should help counter deflation. Finally, Japan stands to benefit from its role as a managerial, financial and technological hub of the world's fastest-growing region.

The big fish small pond problem

Andrew Haldane, Executive Director for Financial Stability, April 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech489.pdf

Speaking at the Institute for New Economic Thinking annual conference in New Hampshire, Andrew Haldane discussed the public policy questions which arise as a result of observed and potential future international capital flows. Mr Haldane referred to the tension between the speed with which emerging market economies' capital markets were widening and the extent to which international investors were seeking to diversify portfolios to spread risk and boost returns, as the 'big fish small pond' (BFSP) problem. Whether this BFSP problem will continue depended on two factors: the degree of 'home bias' among advanced-economy investors; and the change in relative size of emerging market economies' capital markets relative to advanced economies. Mr Haldane's projections suggested that the problem was likely to intensify in the future. In response, he considered the possible public policy responses to the BFSP problem, including the role that capital controls, financial deepening and macroprudential measures might play, in developing new rules of the financial road for global finance.

Mortgages and housing in the near and long term
David Miles, Monetary Policy Committee member, March 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech488.pdf

In this speech, Professor David Miles argued that the UK housing market would not remain depressed beyond a period of a few years. Before the crisis, mortgage lending standards had been too weak. A sudden tightening of loan to value ratios, similar to that experienced since the start of the financial crisis, could be expected to cause a temporary reduction in the demand for housing from first-time buyers. And the smaller the demand from first-time buyers, the fewer subsequent transactions would be triggered between homemovers. But activity would only remain weak while first-time buyers accumulated sufficiently large deposits. Professor Miles concluded that the drop in housing market activity represented a necessary transition towards a more sustainable equilibrium.

Recent developments in the sterling monetary framework
Paul Fisher, Executive Director for Markets, March 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech487.pdf

In this paper, Paul Fisher discussed two key issues for central bankers. First, Paul reviewed the pros and cons of a number of systems for the implementation of monetary policy decisions on Bank Rate, including the pre-crisis system of reserves averaging, and the current 'floor' system for implementing monetary policy. He concluded that the Bank intends to revert to reserves averaging in due course.

In the second part of the paper, Paul discussed some of the operational policy questions raised by the extended-collateral long-term repos, implemented during the crisis to provide market-wide liquidity insurance to the banking system. To resolve these issues the Bank, with the help of Paul Klemperer from Nuffield College, Oxford, an expert in auction theory, redesigned its long-term operations, launching its new permanent indexed long-term repo (ILTR) operations in June 2010. The remainder of the paper discussed the ILTRs in more detail.

Uncertain uncertainty
Martin Weale, Monetary Policy Committee member, March 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech486.pdf

In a speech to the Institute and Faculty of Actuaries, Dr Martin Weale discussed the nature of the uncertainty surrounding macroeconomic forecasts. Dr Weale noted that as interest rate changes take some time to have an effect it makes sense to set monetary policy with reference to where inflation is expected to be in the future. He argued that economic forecasts were therefore a necessary part of the policy process and those forecasts should be in the public domain. But, it was therefore important that producers of forecasts should help outside users of them to understand their limitations.

Dr Weale went on to discuss how the uncertainty surrounding forecasts might best be described. The MPC's *Inflation Report* forecasts are presented as fan charts, rather than point estimates, summarising the assumed probabilities of various outcomes occurring. But even those probability estimates are themselves uncertain. As a contribution to the debate, Dr Weale provided a range of possible alternative depictions of the MPC's forecasts that might help users understand more about the nature of the uncertainty faced by the MPC about the economic outlook.

MPC in the dock
Spencer Dale, Executive Director and Chief Economist, March 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech485.pdf

In this speech, Spencer Dale made the case for the defence of the MPC on four counts: Why is inflation so high? Why has inflation been so much higher than we expected? Could inflation stay high? And how is the current stance of policy consistent with the inflation outlook? On the second count, the explanation for why inflation had been so much higher than expected came in two halves. In 2009, the surprise largely stemmed from the extent of pass-through from higher import prices to consumer prices following the deprecation of sterling. More recently, the surprise largely stemmed from the surge in commodity prices. Finally, he explained his vote at the previous MPC meeting to raise Bank Rate to 0.75%. It was not driven by 'nice' reasons, but instead by a concern that — despite a relatively weak outlook for growth — the risks to the inflation target in the medium term were to the upside.

Capital discipline
Andrew Haldane, Executive Director for Financial Stability, March 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech484.pdf

At the annual meetings of the American Economics Association, Andrew Haldane discussed the success of international capital standards in forestalling banking distress and set out one possible framework that might address some of the observed shortcomings. Mr Haldane defined three principles required for regulatory capital standards to best insure the financial system against crisis: simplicity; robustness; and timeliness. Taking each one in turn, Mr Haldane argued that current regulatory capital ratios might have become too complex and error-prone to meet such criteria. That led him to consider how market-based metrics of bank solvency might offer an alternative to reliance on banks' own risk models. Such metrics are transparent, largely model-free and offer timelier signals of impending stress. Mr Haldane suggested that building into the regulatory capital structure of banks contingent convertible instruments ('Cocos') with triggers based on market-based measures of solvency might reintroduce market discipline by altering incentives of investors, management and regulators. In turn, this would ensure that regulation offered a timely and robust framework for risk management.

Let it grow: how monetary policy can support sustainable economic growth

Andrew Sentance, Monetary Policy Committee member, March 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech483.pdf

In a speech to the East of England CBI, Dr Andrew Sentance discussed the prospects for the economic recovery and how monetary policy can best support it. He noted that prior to the snow-affected 2010 Q4, the recovery was healthy relative to the early 1980s' and 1990s' experiences. In particular, strong global growth supported a strong rebound in manufacturing output. Though weak consumption was likely to hold back growth in early 2011, this reflected short-term factors including higher VAT. As private sector wage settlements increased, consumption growth could rebound and the current episode of high inflation could prove more persistent than the *Inflation Report* outlook suggested. Monetary policy could best support economic growth by fostering a climate of price stability and avoiding destabilising lurches in policy. Failure to take timely action now risked more abrupt rises in interest rates in the future, which could pose a threat to the recovery.

Challenges in note circulation — availability and quality of low-denomination notes

Victoria Cleland, Head of Notes Division, March 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech482.pdf

In a speech at the Currency Cycle Conference in Barcelona, Victoria Cleland, Head of Notes Division, outlined how the Bank is working with the UK cash industry to meet public demand for improved availability and quality of £5 notes. Following a pilot of £5 ATM dispense in 2009, the largest ATM operators agreed to ensure that by 2012 at least 1.2% of their total dispense value was in £5s. This meant that, typically, around 10%–15% of such operators' ATMs were to be reconfigured to dispense £5s. Victoria noted that progress was on track; in 2012 nearly twice as many £5s should enter circulation than in 2010. She explained that a 'virtuous circle' should develop: as more £5s are acquired by the public, and retailers are more able to bank the poorer quality ones, 'the fiver should start to look as familiar — and as smart — as our other denominations'.

Financial stability — objective and resolution

Andrew Bailey, Executive Director for Banking Services and Chief Cashier, March 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech481.pdf

In this speech, Andrew Bailey spoke about the causes of financial crises and the inherent risks that exist through the activities that banks undertake. He emphasised the importance of financial stability being seen as a public policy objective and for the public having to have a greater understanding of what it involves.

Andrew discussed the Government's consultation paper which aimed to define the financial stability objective that the Financial Policy Committee would be given. He highlighted three important areas for the Government to include in legislation, namely transparency, accountability and the importance of a purposive approach to interpreting legislation.

Andrew finished by discussing the problem of too big/too important to fail institutions, and the work under way to create a resolution tool which would remove the unacceptable dependence of banks on public money.

Do we need an international monetary system?

Mervyn King, Governor, March 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech480.pdf

In this speech, the Governor began by noting that the emergence of the imbalances in current accounts over the past 20 years had had huge effects on the global pattern of spending, creating unsustainable paths for domestic demand, net debt and long-term real interest rates. The main lesson from the experience was that national policy frameworks alone were unable to prevent components of demand from growing at unsustainable rates while maintaining satisfactory growth in the economy as a whole.

Fixed, or managed, exchange rate regimes may help to limit the real economic costs of 'excessive' volatility that reflected short-lived shifts in market sentiment, but if they impeded desirable adjustments of real exchange rates, they could contribute to unsustainable patterns of spending. Given imperfections in financial markets in both borrowing and lending countries, such capital flows could lead to a degree of fragility, such that, when adjustment came, there was a high probability that it would be abrupt.

The immediate issue of how to move to a more sustainable position required a resolution of different countries' economic strategies for rebalancing — there could be only one path. So there must be scope, in the short term, for a 'grand bargain' to adopt a set of policies that would support an agreed path of rebalancing and avert a move towards protectionism. This should be the central objective of the G20's Framework for Strong, Sustainable and Balanced Growth.

The Governor concluded by saying that he felt the most obvious problem at the global level was that current account imbalances were growing again. Recognising the common interest in moving to a more sustainable pattern of world demand was in everyone's self-interest.