Bank of England speeches

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

Monetary policy in a weak economy

Martin Weale, Monetary Policy Committee member, November 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech535.pdf

In a speech delivered at the National Institute of Economic and Social Research, Dr Martin Weale reviewed the United Kingdom's unusually slow recovery from recession. He noted that there were two striking features: first, productivity had recovered, but not regained its previous path; second, household consumption had been weak, particularly when compared to disposable income. Dr Weale considered the connections between these and concluded that worsened productivity performance was probably one factor contributing to the weakness of consumption. On top of this, it was possible that pre-crisis consumption in the United Kingdom was simply too high.

Dr Weale argued that while the economy needed to rebalance away from consumption, renewed asset purchases supported consumption and these were required to prevent inflation falling below target in the medium term. Dr Weale concluded by noting that monetary policy was only one part of overall economic policy and could not, on its own, set the economy on a sound and sustainable growth path.

Promoting a prudent and stable financial system

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

www.bankofengland.co.uk/publications/speeches/2011/speech534.pdf

In this speech, Andrew Bailey discussed the pressures facing the banking sector and retail banking more specifically. Andrew spoke about how, earlier in the year, the authorities have worked with the banks to build their liquidity buffers and reduce their balance sheets in order to provide more protection against future stresses.

Andrew noted the deterioration in funding market conditions since the summer. He discussed how UK banks were not singled out, primarily because they do not have large direct exposures to vulnerable eurozone economies. Andrew added that it was important that banks plan for any disorderly consequences of the euro-area crisis.

Andrew spoke about the strains on retail banking from the sustained low interest rate environment and the impact this was having on the ability for banks to lend. Additionally, he discussed how the pricing of retail banking was becoming more opaque, and charges are levied inconsistently across products, with the consequence that some appeared free.

Lessons in lobbying

Robert Jenkins, Financial Policy Committee member, November 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech533.pdf

In this short speech, Robert Jenkins outlined the short-sightedness of the banking industry's lobbying efforts. He described the evolution of the recent approaches used by banking sector lobbyists from denying the need for reform, through advocating the need for reforms to be at a global level in the hope that they would be set to the lowest common denominator, to blaming the Basel rules for forcing banks to reduce their real-economy lending. The latest lobbying effort is intellectually dishonest because it is the market that is currently driving banks to improve their health and banks can do so without harming the real economy, for example by cutting bonuses and intra-financial risk-taking, and raising equity. Banks risk making the case for more regulation. Robert concluded by calling on bank leaders to lobby less and lead more.

A few remarks on current monetary policy in a rebalancing economy

Paul Tucker, Deputy Governor, November 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech532.pdf

In this speech, Paul Tucker discussed current monetary policy in light of the need for the UK economy to rebalance. Tight credit conditions were probably impeding reallocation of capital across the economy; it was also making labour market conditions harder to interpret. It was possible that firms benefiting from increased exporting opportunities had been hiring, while some firms in shrinking sectors had so far maintained headcount. He concluded that the ferocity of the shocks that had hit the economy, and the pervasive uncertainty that persisted about global economic and financial conditions, were circumstances where taking longer than usual to re-achieve the MPC's 2% target were warranted, provided that the Committee's credibility was underpinned. The credibility of monetary policy was an absolute precondition for maintaining support to demand. Over the next few quarters it would become clearer whether the Committee's big judgement call on inflation — that it will fall rapidly from its current elevated level — will prove correct.

Mortgages, housing and monetary policy — what lies ahead?

David Miles, Monetary Policy Committee member, November 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech531.pdf

In a speech delivered to the Northern Housing Consortium, David Miles — external member of the Monetary Policy Committee — discussed how the financial crisis had transformed the UK housing and mortgage markets. First-time buyers now needed to postpone their purchases in order to save for a larger deposit and in the future may increasingly look at alternative schemes for financing house purchases with more outside equity that could bridge some of the gap between mortgage loans and deposits and also bring risk-sharing benefits. He predicted that this need for equity would lower the rate of owner-occupation. In the short term this created transitional problems — particularly for house builders — and recent Government policies had been designed to counter them. But in the longer term a lower rate of owner-occupation, and a bigger rental sector, did not need to be a negative outcome — it could help to offset tax distortions that work against renting and stabilise the housing and mortgage markets, and ultimately the wider economy. Monetary policy might need to be recalibrated but would not be less effective.

The economic outlook

Charles Bean, Deputy Governor, November 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech529.pdf

In a speech to the Council of Mortgage Lenders, Deputy Governor Charlie Bean explained the MPC's decision to restart its quantitative easing (QE) programme. He noted the contribution of heightened financial market tensions and the impact of squeezed real household incomes to a global slowing in growth. This had increased the chance that inflation would undershoot the 2% target in the medium term which had led the MPC to restart asset purchases. Charlie Bean saw no reason to believe that the impact of asset purchases had changed since the earlier phase of QE. He also considered the case for alternative stimulus in the form of vouchers, concluding that temporary increases in disposable income were likely to be largely saved. In conclusion he recorded the period of transition in the housing market and the potential support to consumption and mortgage demand of a moderation in the squeeze on household incomes.

Remarks by Robert Jenkins

Robert Jenkins, Financial Policy Committee member, November 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech528.pdf

In this short speech, Robert Jenkins noted that the primacy given by banks to return on equity (RoE) as a measure of profitability is wrong-headed. It does not adjust for the risks taken by banks to achieve RoE targets. And it incentivises banks to try to minimise the equity they hold and to lobby hard against reforms aimed at increasing minimum capital requirements. Robert outlined how successful investors are not interested in RoE *per se*, they are interested in high risk-adjusted returns. As such, if banks take on higher risks, including by leveraging up, to earn a higher RoE, investors should adjust for this risk. Such an adjustment would increase the cost of capital for riskier banks. Robert concluded his speech by stating that RoE targets had to go and called on the investment community to explain this to banks and sell-side analysts.

The capital conundrum

Robert Jenkins, Financial Policy Committee member, November 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech527.pdf

In this speech, Robert Jenkins discussed the confusion surrounding the cost of bank capital generally and the importance of equity specifically. Bankers have sought short-term high returns on equity (RoE). Aggressive RoE targets have not produced shareholder value but have produced systemic instability. The flaw resides in the fact that risk-taking firms were guided by a non risk-adjusted target. Robert called on the investment community to explain to banks that investors do not seek high RoE-producing enterprises. They seek high relative risk-adjusted returns. Banks with less equity are clearly more dangerous than those with more equity in the balance sheet mix. Investors will judge them accordingly. A bank with more equity and less leverage will enjoy a lower cost of capital, less volatile returns, a higher earnings multiple and quite possibly better shareholder value. Robert concluded that instead of fighting a higher equity requirement, bankers should welcome it.

Balancing security and aesthetics: the evolution of modern banknote design

Chris Salmon, Executive Director for Banking Services and Chief Cashier, October 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech526.pdf

In a speech addressing the British Numismatic Society on 25 October, Chris Salmon set out the evolution of the Bank's current approach to secure banknote design and its value in ensuring public confidence in our issuance. Chris also unveiled a new security feature of the forthcoming £50F, launched on 2 November, and highlighted the progress to date in increasing the quality of £5 notes in circulation.

Chris additionally explained the need for continued vigilance on the Bank's part with regard to emerging technologies which could be used by counterfeiters, and set out how the Bank's education programme and collaboration with the police further support the Bank's public confidence objective.

The speech also drew together a summary of the Bank's issuance history, with particular regard to the Bank's changing views as to how the banknote aesthetics influence their security. He paid tribute to Harry Eccleston OBE, lead designer of the 'D' series of notes first issued between 1970 and 1981, who sadly passed away in April last year.

Control rights (and wrongs)

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

www.bankofengland.co.uk/publications/speeches/2011/speech525.pdf

Delivering the Wincott Annual Memorial Lecture, Andrew Haldane set out four structural factors which have led banks to take on too much risk. First, the introduction of limited liability 100 years ago meant that equity holders benefited from increases in firm value while losses were capped at zero. So if banks sought to maximise shareholder value, they would take on bigger and riskier bets. Second, biases in the tax system favoured debt over equity such that equity had, until the eve of the crisis, become a vanishingly small fraction of banks' balance sheets. Third, the notion of 'too big to fail' meant that debt holders did not have the incentives to restrain banks from risky activities because they were unlikely to face losses. Fourth, inappropriate performance targets such as return on equity meant that investors had incentives to increase their short-term equity-based return.

For each of these factors, Andrew Haldane set out possible solutions to better align bank risk-taking incentives with the public good. To reduce banks' appetite to take on too much risk and reduce the probability of public sector support, banks should hold higher equity and other loss-absorbing instruments such as convertible capital. To ensure that equity holders do not take risky decisions at the expense of other liability holders, the ownership and control of banks could be widened. And to avoid banks focusing their performance on a narrow set of the balance sheet (equity), banks could target the return on assets rather than the return on equity. All of these actions would seek to address the imbalance that has built up over 100 years between risk and return in the financial system.

Central counterparties: the agenda

Paul Tucker, Deputy Governor, October 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech524.pdf

In this speech, Paul Tucker discussed several issues essential to underpinning the safety and soundness of central counterparties (CCPs). First, with exchanges being combined with clearing into vertically integrated groups, he said CCP risk managers should have clear and independent reporting lines to group boards. Second, a balance would need to be struck between effective risk management and broadening access to global CCPs. Third, he called for the development of effective resolution regimes for CCPs (and other financial market infrastructure), in order to preserve a CCP's essential services and minimise disruption and value destruction. Clearing members should probably bear the brunt of 'recapitalising' CCPs. Finally, he said minimum initial margin requirements should apply across markets, and beyond over-the-counter contracts. European legislation should make explicit provision for minimum margin requirements to be altered by the authorities in light of changes in the risk environment.

Speech by the Governor, Mervyn King

Sir Mervyn King, Governor, October 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech523.pdf

The Governor began by noting that the UK economy had enjoyed the benefits of globalisation. Now it was seeing some of the costs, as they played out in a global financial crisis.

The underlying problem, which was one of solvency not liquidity, had not gone away. And this was reflected in the continuing imbalance between those economies running large current account surpluses and those running large current account deficits. One way or another, domestic spending had to be raised in the surplus countries and lowered in the deficit countries, relative to trend.

In the past, market-determined exchange rates had played an important role in rebalancing world demand and trade. It was crucial to the health of the world economy that a way was found of allowing competitiveness to adjust so that trade imbalances, and hence the present scale of indebtedness, could be reduced.

From the perspective of the United Kingdom, to enable rebalancing the objective was to steer the economy slowly back to a position of more normal interest rates and lower budget deficits. With a lower level of sterling and a credible plan to reduce the fiscal deficit over the medium term that was on track. But the marked slowing of the world economy, especially in the euro area, would be a threat to that strategy.

The Governor noted that, at 5.2%, inflation was uncomfortably high in the most recent data. It was the weaker outlook for inflation, rather than its current high rate, that explained the MPC's decision to resume asset purchases at its October meeting. The Governor explained the mechanism by which asset purchases were likely to work. This should benefit all companies and households. But it could not solve the underlying problem of indebtedness. Easy monetary policy, by bringing forward spending from the future to the present, meant that the ultimate adjustment of borrowing and spending would need to be even greater.

The Governor concluded that the fundamentals of the UK economy were strong. But without a rebalancing of spending in the world economy, a struggle between debtor and creditor countries would continue to inflict economic pain on everyone. It was important to use the gravity of the global crisis to provoke a bold response. Policymakers from all nations had acted together in 2009; they could do so again.

Why prudential regulation matters

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

www.bankofengland.co.uk/publications/speeches/2011/speech522.pdf

In this speech at the APCIMS conference, Andrew Bailey considered the challenges faced in the reform of financial supervision. Andrew spoke about the importance of Parliament clearly rooting the objectives of supervision in public policy. He compared the current position to monetary policy where the Bank has a clear public policy responsibility.

Andrew discussed the clear objective for the Prudential Regulation Authority; to pursue safety and soundness of firms in order to achieve the stability of the financial system, and noted that this does not mean a 'no-failure' regime.

Andrew also spoke about the role of judgement by supervisors, and forward-looking supervision. He noted the increase in European rule-making, and how this can make it more difficult to implement judgement-based supervision without a clear objective in public policy.

Andrew reiterated the need for supervisors to raise the key issues with regulated firms. He said it was important that firms had well-functioning risk and audit functions that are active and able to strongly advise senior management when there are issues with the firms' control framework.

Monetary policy and financial dislocation

David Miles, Monetary Policy Committee member, October 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech521.pdf

In a speech to the Royal Economic Society, Professor David Miles discussed the mechanisms through which asset purchases affect the wider economy and how powerful they might be in the current situation. The economic outlook had worsened since August, prompting the Monetary Policy Committee to increase the size of the Bank of England's asset purchase programme. Asset purchases were expected to stimulate domestic demand via several channels.
Professor Miles focused on two: first, investors who sold gilts to the Bank would invest in riskier assets of similar duration, making it easier for firms to raise funds directly in financial markets. Second, asset purchases increase deposits at banks. When bank lending is constrained by the amount of funds that banks can raise, a larger deposit base might support bank lending and consumption and investment by bank-dependent borrowers. By stimulating demand, asset purchases could help close the gap between demand and supply and prevent inflation further ahead from falling below target.
Professor Miles argued that purchases now might be as effective as in 2009/10.

Rebalancing and the real exchange rate

Ben Broadbent, Monetary Policy Committee member, September 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech520.pdf

Ben Broadbent's speech examined the cause and consequences of sterling's depreciation in 2007–08. First, he argued that it was not caused by monetary policy; rather it was a result of the need to rebalance UK supply away from non-traded goods and services, and towards the production of tradables, to meet a new pattern of demand — in particular, lower government consumption. Second, he argued that the process of rebalancing — and the size of the exchange rate depreciation necessary to induce it — depends on how easy it is to reallocate productive resources between sectors of the economy; something hampered by the state of the banking sector. Third, he argued that rigidly sticking to the inflation target through this period would have involved significant economic costs, costs that the MPC's remit explicitly tells it to avoid. He concluded by drawing some longer-term lessons; the inflation-targeting regime remains credible, but there are limits to what monetary policy can hope to achieve.

Productivity and monetary policy

Spencer Dale, Executive Director and Chief Economist, September 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech519.pdf

In a speech to the South Tyneside Manufacturing Forum, Spencer Dale discussed productivity in the United Kingdom: a crucial factor in determining the balance of supply and demand in the economy and therefore inflation. He observed that the level of productivity was no higher than at the start of the financial crisis, three years previously. Productivity was therefore 9% lower than had it continued growing at its average rate from before the crisis, which was both a puzzle and a concern.

Spencer Dale offered three possible explanations for this shortfall in productivity. First, measured productivity may understate the supply capacity of the economy if data were mismeasured or if firms had 'hoarded' labour during the recession. But firms had been reporting little spare capacity and had increased employment strongly over the past year, suggesting they had little spare capacity. Second, looking at productivity data by sector suggests that it was probably unrealistic to have expected that productivity would have continued to grow at the same average pace as it had done prior to the financial crisis. The third possibility is that underlying productivity growth has been weakened by the impact of the financial crisis. Spencer placed greater weight on the third of these explanations, although all three were likely to have contributed to weak productivity growth.

Macroprudential policy: addressing the things we don't know

Alastair Clark, Financial Policy Committee member, and Sir Andrew Large, former Deputy Governor of the Bank of England, September 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech518.pdf

In this paper, Alastair Clark and Andrew Large discussed how macroprudential policy — targeted at system-wide conjunctural and resilience risks — could be used to fill the gap between monetary policy and microprudential regulation. A statutory framework is favoured to ensure clarity and accountability of decision-making, while retaining sufficient flexibility to respond to evolving risks and policy developments — including the potential to transfer leadership from central banks to finance ministries upon crystallisation of systemic risks. An integrated approach is proposed to consider interlinkages with other policy areas, both in terms of overlapping toolkits and spillover effects that may demand judgements about competing priorities. A number of potential tools and data sources are discussed, subject to an overarching need for intelligent use of both quantitative and qualitative analysis to inform decisions. This may also require the determination of a systemic risk appetite against which the costs and benefits of policy options may be considered. While differences in fiscal and legal frameworks currently restrict international convergence to areas of standard-setting, the increasing degree of global interconnectedness may necessitate greater international co-ordination of macroprudential policy.

How to do more

Adam Posen, Monetary Policy Committee member, September 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech517.pdf

In this speech, Dr Posen called for further monetary policy stimulus in the United Kingdom and abroad. Policy defeatism was unjustified because monetary ease would encourage restructuring and still be effective. Poor credit availability and heightened risk aversion beset all G7 economies, and monetary policy could reduce those problems. He also called for greater co-operation between the Bank of England and the British Government to encourage investment in small and medium-sized enterprises (SMEs), given the United Kingdom's structural deficiencies in domestic finance. Dr Posen advocated a two-part policy: first, additional traditional quantitative easing, with the purchase of £50 billion to £100 billion of government gilts over the next three months; second, the creation by the Government of a lending bank and a securitiser of loans to improve the provision of credit to SMEs. Working with the Government, the Bank would provide liquidity and discounting of high-quality securitised loans for these new entities.

Enhancing financial stability: the role of transparency

Donald Kohn, Financial Policy Committee member, September 2011.

www.bankofengland.co.uk/publications/speeches/2011/speech516.pdf

In this speech, Don argued that transparency could help to ensure financial stability. Don suggested that a lack of transparency contributed to a mispricing of risk in the run-up to the previous crisis, and exacerbated the downturn, as contagion fed on uncertainty about the financial health of counterparties.

By way of improvements, detailed quarterly reporting of financial statements, including averages and intraday metrics, may help ensure that the condition of financial institutions is fairly represented in a timely manner. And provision of full information about the structure of individual instruments may reduce opaqueness and increase market confidence.

Increasing transparency is not without cost, however. Collecting information is costly; excessive requirements may unnecessarily distract management; and increased transparency may threaten legitimate competitive advantages.

The effectiveness of the FPC in preserving financial stability would also be dependent upon a high level of transparency about its concerns, recommendations and deliberations. This will be aided by the clear reflection of debates and recommendations in FPC meeting Records.