Bank of England speeches

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

Towards a common financial language

Andrew Haldane, Executive Director for Financial Stability, March 2012.

www.bankofengland.co.uk/publications/Documents/speeches/2012/speech552.pdf

In a joint paper with Robleh Ali and Paul Nahai-Williamson delivered at the SIFMA Legal Entity Identifier Symposium in New York, Andrew Haldane discussed how the financial crisis had exposed information failures in the financial system and the case for adopting a common financial language as a solution.

Andrew described how the key elements of this language would be Legal Entity Identifiers (LEIs) and Product Identifiers (PIs), which uniquely identify counterparties and products respectively. Like any other language, it could describe the most complex financial transactions by breaking them down into simpler elements and creating a grammar for describing how those elements fit together.

Product supply chains and the World Wide Web were given as two examples where creating a common language was revolutionary. In both cases, a common language led to more accurate network mapping, less systemic risk, a reduction in barriers to entry and greater innovation. The financial system has lagged these two global industries by decades in its development of common data standards and its exploitation of technology for information management. By introducing a common language, the financial system could be made more transparent to both banks and regulators, helping them monitor and reduce systemic risk and allowing new participants to enter, encouraging competition.

Insurance, stability and the United Kingdom's new regulatory architecture

Paul Tucker, Deputy Governor, March 2012.

www.bankofengland.co.uk/publications/Documents/speeches/2012/speech551.pdf

In this speech, Paul Tucker outlined how the insurance industry fits within the UK authorities' efforts to make the financial system more resilient. He highlighted the potential for insurance firms to build shadow banks within their businesses. Related to that there was a need to put some structure around the securities lending, perhaps by introducing a trade repository to create some daylight. On microregulation, he expressed concern that Solvency II risks being too complicated, with too much stress on detailed approval of models. Supervisors would need to focus on the big risks to the safety and soundness of a firm. Insurers must be able to fail in a controlled, orderly way. That was underlined by the progressive withdrawal of the safety net of banks, to which insurers were major lenders.

Policymaking at the Bank of England: the Financial Policy Committee

Paul Fisher, Executive Director for Markets, March 2012.

www.bankofengland.co.uk/publications/Documents/speeches/2012/speech550.pdf

In this speech, Paul Fisher spoke about the new Financial Policy Committee (FPC), established as part of the wide-ranging overhaul of the United Kingdom's financial stability arrangements. The FPC's responsibilities include detecting and reducing threats to the financial sector, and setting macroprudential policy to enhance the resilience of the financial system as a whole, so that the costs of financial instability shocks are reduced. Paul discussed the progress and recommendations of the FPC to date, the realised benefits of closer interaction between the Bank and the FSA, and some of the potential challenges the FPC will face going forward. In particular, Paul discussed the risk of conflict between the decisions of the MPC and the FPC, concluding that separate policy committees, each with a single clear responsibility, sufficiently independent instruments, a common chair and overlapping membership, should ensure that this risk is minimised.

Asset prices, saving and the wider effects of monetary policy

David Miles, Monetary Policy Committee member, March 2012.

www.bankofengland.co.uk/publications/Documents/speeches/2012/speech549.pdf

In this speech, David Miles outlined his view of the current stance of monetary policy, and discussed how asset purchases might be affecting the economy. He described the two main channels through which he believes asset purchases boost demand: the portfolio rebalancing channel; and a bank funding channel. Professor Miles also discussed the impact of asset purchases on those saving for retirement. He noted that the impact of asset purchases on retirement resources depends not only on what the purchases do to gilt yields, and so to annuity prices, but also on what they do to the value of retirement savings. If those about to retire hold assets — gilts, corporate bonds, equities, or residential property, for example — and monetary policy generates rises in the prices of those assets, it can offset some, or all, of the effects of rising annuity prices. And the impact of monetary policy on the real economy — on GDP and on unemployment — will affect welfare too.

From retailers' paradise to shoppers' strike: what lies behind the weakness in consumption?

Martin Weale, Monetary Policy Committee member, February 2012.

www.bankofengland.co.uk/publications/Documents/speeches/2012/speech548.pdf

In a speech delivered at Cass Business School, Dr Weale began by noting that the adjustment in consumption over the recent period of recession and stagnation had been more gradual than might have been expected and provided some possible reasons for this. First, it has only gradually become clear how large the adverse shock to incomes has been; second, people may continue to follow their habits and therefore not adjust their spending patterns initially; and third, by rapidly cutting Bank Rate, the MPC encouraged consumers to bring forward consumption.

Dr Weale then went on to explore some of the factors weighing down on consumption. He noted that the real wages of fully employed young adults had fallen than more than those of older people since the crisis began, and, since the young rely more than older people on their current and expected future wage income as a means of financing consumption, this could have resulted in a fall in consumption larger than if wages had declined uniformly across ages. Dr Weale considered whether uncertainty could be depressing consumption and concluded that an increased risk of unemployment could produce a marked effect, but that it faded over time. Changes to the state benefit system were also considered and he suggested that an increase in the state pension age was likely to lead to a savings rate higher than the pre-crisis average. Finally, Dr Weale argued that credit conditions had not worsened since the early part of the financial crisis and, hence, were unlikely to contribute to further rises in the saving rate. The overall conclusion was that consumption should be expected to grow more slowly than income over the medium term.

National balance sheets and macro policy: lessons from the past

Paul Tucker, Deputy Governor, February 2012.

www.bankofengland.co.uk/publications/Documents/speeches/2012/speech547.pdf

In this speech, Paul Tucker discussed some lessons learned from the financial crisis about the appropriate macro policy framework, in particular from the overstretched balance sheets accumulated by the Western world. Prior to the crisis, robust credit growth and asset price appreciation were encouraged by two international macroeconomic factors: a fall in the world safe real rate of interest, triggered by excess savings in the East; and increased global liquidity, transmitted through expansive cross-border lending, and kicked off by prolonged accommodative monetary policy. Both involve shifts in risk premia. Risk premia can be key drivers of fluctuations in asset prices, and probably have substantial influence over macroeconomic fluctuations. Policymakers need to be alive to the possibility that monetary policy can affect risk-taking. Developments in national balance sheets need to be closely monitored. Where imbalances are identified, macroprudential tools should be used to temper them.

Quantitative easing and the economic outlook

Charles Bean, Deputy Governor, February 2012.

www.bankofengland.co.uk/publications/Documents/speeches/2012/speech546.pdf

In a speech to the Scottish Council for Development and Industry, Deputy Governor Charlie Bean described the economic outlook and discussed recent MPC actions. Although recent indicators of UK growth had been encouraging and the squeeze on real household incomes had started to ease, he noted the significant headwinds to the pace of recovery. Without additional asset purchases announced by the MPC, inflation would more likely than not undershoot the 2% target in the medium term, he said. Charlie Bean described the transmission mechanism for asset purchases and saw little evidence to suggest that the impact had markedly changed. He also noted that the impact of lower interest rates on new annuity incomes would be offset by an increase in pension savings as asset prices rose. He concluded that loose monetary policy was necessary now in order to sustain demand and return to more normal policy settings in the future.

Three principles for successful financial sector reform

Chris Salmon, Executive Director for Banking Services and Chief Cashier, February 2012.

www.bankofengland.co.uk/publications/Documents/speeches/2012/speech545.pdf

In a speech delivered at City Week 2012, Chris Salmon began by recapping the objectives of the financial sector reform programme and the key building blocks through which it will be implemented in the United Kingdom. While acknowledging the inherent challenges of implementing such significant changes, he described three guiding principles for successful implementation. First, it is better to manage the costs of change by having a long transition period than to water down the reform. Second, there is a need for strong dialogue both between public authorities to maximise consistency of approach and between market participants and the public authorities to understand the potential impact of the reforms. Finally, Chris advocated the need to build in mechanisms which allow rules to be amended, recalibrated or adjusted. In the medium term, market participants will need to adjust their businesses to take full advantage of the opportunities that the new regulatory framework and other structural changes provide.

Introductory remarks by Paul Tucker at the book launch for *Investing in change: the reform of Europe's financial markets*

Paul Tucker, Deputy Governor, February 2012.

www.bankofengland.co.uk/publications/Documents/speeches/2012/speech544.pdf

In this short speech, Paul Tucker gave some introductory remarks at the book launch for *Investing in change: the reform of Europe's financial markets*. He focused on the chapter of the book that he authored entitled 'Banking in a market economy — the international agenda' which examined one of the central principles of reform: banks should not depend on a safety net from taxpayers. That will require banks to carry considerably more capital and liquidity, as planned by the Basel Committee. It will also require resolution regimes to manage the failure of systemically important financial institutions in an orderly way. A blueprint for such regimes has been agreed by G20 leaders. These changes come with three implications. First, in a world of less leveraged banks, a business model of Originate and Warehouse is unlikely to be as prevalent. Second, holders of bank debt will be exposed to risk, and so will have a large incentive to monitor the riskiness of banks. Third, withdrawing the safety net from banks will require other parts of the financial system to be sound, and robust to bank failures.

Towards a new architecture for payment arrangements

Chris Salmon, Executive Director for Banking Services and Chief Cashier, January 2012.

www.bankofengland.co.uk/publications/Documents/speeches/2012/speech542.pdf

In a speech delivered at the BAFT-IFSA Global Annual Meeting, Chris Salmon described how the financial crisis has influenced the perspective of financial stability policymakers towards payment operations. He argued that this will impact banks in two main ways. First, authorities are likely to place more attention on the overall network of payment operations within a financial system, including the pattern of direct and indirect participation in payment systems. Here he reiterated the Bank's view that an increase in direct participation in CHAPS would be good for UK financial stability. Second, in the context of resolution plans and the focus on ensuring orderly resolution of financial institutions, including the recommendations of the Financial Stability Board, authorities are likely to ask more questions about the internal organisation of firms' operations.

Chris concluded by encouraging financial institutions to consider the attitudes of financial stability authorities and the broader regulatory backdrop when developing their medium-term planning.

Speech by Mervyn King, Governor

Sir Mervyn King, Governor, January 2012.

www.bankofengland.co.uk/publications/Documents/speeches/2012/speech541.pdf

The Governor began by noting that inflation had started to fall. That would relieve the squeeze on real income growth and with it the pressure on consumer spending.

But 2012 would not be an easy year. Three factors had been shaping the economic environment and would continue to act as headwinds in 2012. First, credit conditions would be tight while problems in the euro area persisted. Second, household savings were elevated, reflecting uncertainty about future incomes. And, third, the world economy was experiencing a slowdown.

The common thread in all three factors was the need to correct overleveraged balance sheets. After many years in which the stock of debt had built up rapidly, there had been a reappraisal. The world economy was moving to a new equilibrium.

The Governor asked what this meant for policy in the United Kingdom? The main objective of policy was to ease the inevitable adjustment. Three areas were particularly important. First, monetary policy, where low short-term interest rates and unprecedentedly low long-term interest rates would help to smooth the adjustment of balance sheets. Second, rebuilding a healthy and competitive banking system would improve access to credit. And, third, supply-side reforms would boost future incomes.

The Governor concluded that it would take time, but helped by the right policy actions the UK and world economies could and would recover. And when they did so, they would be on a more sustainable footing than at any point in the previous fifteen years.

Accounting for bank uncertainty

Andrew Haldane, Executive Director for Financial Stability, January 2012.

www.bankofengland.co.uk/publications/Documents/speeches/2012/speech540.pdf

In remarks given to the Institute of Chartered Accountants in England and Wales, Andrew Haldane argued that existing accounting rules for banks had amplified investor and regulatory uncertainty. The special characteristics of banks' balance sheets might call for a distinct accounting regime to lean against this. Specifically, valuing assets at so-called 'fair value' had played a role in extending financial upswings, while the retreat from fair values had elongated financial downswings when banks were unable to accurately value their assets. To deliver a more robust regime for banks, two issues needed to be recognised. First, the intrinsic uncertainty around the value of banks' assets should be quantified. Progress has recently been made in providing such information to regulators. In time, this ought to be provided to investors. Second, the mismatch between banks' assets and liabilities generates an inherent fragility. To recognise this, auditors should have scope to adopt a more graduated, less binary, approach to making 'going concern' assessments of a bank's solvency.

What the return of 19th century economics means for 21st century geopolitics

Adam Posen, Monetary Policy Committee member, January 2012.

www.bankofengland.co.uk/publications/Documents/speeches/2012/speech539.pdf

In this speech, Dr Posen drew parallels between the underlying global economic environments of the late 19th century and of today. In particular, he compared the interaction between the United Kingdom and the United States in the prior period to what he expects between the United States and China in the next two decades. Based on these similarities, he offered a number of predictions for the longer-term macroeconomic outlook. He argued that globalisation will continue, with increasing support from important constituencies in emerging markets. As US hegemony recedes into multipolarity, the international economic system will have less strict rule enforcement and be subject to greater economic volatility. This will have significant effects on the global division of labour, which will reinforce this multipolarity and income convergence. Price stability will prevail, with sharper fluctuations around low average inflation driven by real shocks, and deflation will occur from time to time. More than one currency will play a global or reserve role. International diversification of investment will increase, and so will the gross flows of capital, with capital accounts in the major emerging markets moving more towards balance if not deficit.

Why banks must think carefully before they shrink their assets

Robert Jenkins, Financial Policy Committee member, December 2011.

www.bankofengland.co.uk/publications/Documents/speeches/2011/speech538.pdf

In this short article, Robert Jenkins noted that European regulators had asked European banks to increase their capital ratios by June 2012. Banks could achieve this in two ways, by increasing their capital levels (equity plus qualifying debt), or by reducing their assets.

Robert noted that the two approaches would have different implications for the resilience of banks and for the health of the economy. Boosting capital levels would improve banks' capacity to absorb losses and so boost confidence in their resilience. Shrinking loans to households and businesses would harm the economy which would harm banks' resilience.

Unfortunately, bank executives remained excessively focused on return on equity (RoE) to measure their success. RoE was a flawed measure, it did not account for risk and disincentivised bank executives from increasing levels of equity. Robert concluded by urging banks to think carefully about these considerations.

Prospects for monetary policy: learning the lessons from 2011

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

www.bankofengland.co.uk/publications/Documents/speeches/2011/speech537.pdf

In this speech, Spencer Dale argued that the main reason growth had disappointed over the past year was that household consumption had fallen sharply, due largely to the fall in households' real incomes associated with the increases in VAT, energy prices and other import prices. However, the euro-area crisis seemed the most likely reason for the material weakening in the UK outlook more recently. How deep and persistent this slowing would be was very uncertain.

Spencer addressed some criticisms levelled at quantitative easing (QE). He refuted that undertaking QE signalled a reduced commitment to hitting the inflation target. He recognised the impact that low interest rates had on many savers and pensioners but argued that most people in our society, including pensioners, would be even worse off had monetary policy responded less aggressively. Low gilt yields did not imply that there was little scope for QE to be effective. Nor would the money just sit in banks. Finally, he did not believe that the MPC should have purchased a greater range of private sector assets to provide more support to small and medium-sized enterprises. Complementary policies were better suited to this.

Spencer separated the outlook for inflation into two phases. In the first, to March 2012, CPI inflation should fall rapidly as the price level increases from the VAT rise and the increase in petrol prices in early 2011 drop out of the inflation rate. But how persistent inflation would be thereafter was more uncertain and important. He believed the chances of inflation being above or below the target towards the end of 2012 and into 2013 were more balanced than those embodied in the November *Inflation Report* fan chart.

The Financial Policy Committee at the Bank of England

Donald Kohn, Financial Policy Committee member, December 2011.

www.bankofengland.co.uk/publications/Documents/speeches/2011/speech536.pdf

In this speech, delivered at the US Department of the Treasury Conference, Don Kohn gave an overview of the new macroprudential policy framework at the Bank of England and the work of the interim Financial Policy Committee.

Don noted that the pre-crisis lack of a single institution with responsibility, authority, and powers to monitor the financial system as a whole motivated the need for a macroprudential authority in the United Kingdom.

Don explained that the Committee's recommendations to date had fallen into one of two broad categories: acquiring additional information necessary for the FPC and markets to monitor and take actions to contain risks to financial stability, and attempting to build additional resilience into the banking system without impairing its willingness or ability to perform key intermediary functions.

Finally, Don recognised that implementing countercyclical macroprudential policy would be challenging. In bad times, actively encouraging drawing down of capital and liquidity buffers would not be easy for policymakers. And in good times, the system would appear strong and there would be resistance to dampening the upswing.