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.

What should monetary policy do?

David Miles, Monetary Policy Committee member, February 2013.

www.bankofengland.co.uk/publications/Documents/speeches/2013/speech636.pdf

In this speech at the University of Bath, Professor Miles discussed what the optimal monetary policy in the United Kingdom is today. He explained that due to the uncertainties surrounding economic forecasts and the effectiveness of monetary policy tools, monetary policy needs to take calculated risks. He stressed that focusing on the most likely outcomes conditional on unchanged policy does not tell us what the right monetary policy is.

Professor Miles developed a simple model to explore how some of the most significant sources of uncertainty affect monetary policy under the flexible inflation-targeting regime defined by the Monetary Policy Committee's remit. Based on plausible ranges for the degree of spare capacity, the sensitivity of productivity to demand, the effectiveness of monetary policy and the strength of a recovery conditional on unchanged policy, he found that a strong case can be made for more expansionary monetary policy.

The balance of payments

Martin Weale, Monetary Policy Committee member, February 2013.

www.bankofengland.co.uk/publications/Documents/speeches/2013/speech635.pdf

In a speech delivered at the Warwick Economics Summit, Martin Weale discussed the United Kingdom's balance of payments position. He suggested that the full benefits of the 2007/08 depreciation may yet to be realised; high levels of uncertainty may have prevented exporters from seeking new markets and domestic producers from displacing imports. However, he noted that the United Kingdom's external account has historically recorded a net surplus of investment income, but that as this has eroded, the overall deficit had increased to around 3½% of GDP, higher than before the depreciation. Unless capital gains continue to accrue, he suggested that this points to a marked increase in UK net external debt at the current exchange rate. Martin Weale concluded that the likely outcome of this would be a lower real exchange rate which, while unwelcome in terms of its effect on inflation, would go some way to redress what is probably, at present, a substantial external imbalance.

The evolution of insurance regulation: a shifting scope and new frontiers

Andrew Bailey, Executive Director, February 2013.

www.bankofengland.co.uk/publications/Documents/speeches/2013/speech634.pdf

In a speech delivered at the Market Force and the Chartered Insurance Institute's Nicholas Barbon Lecture on 6 February, Andrew Bailey reviewed the Prudential Regulation Authority's (PRA's) approach towards supervising insurers. Andrew's speech centred on three themes: why it makes sense to place the prudential supervision of insurance in the PRA; how the PRA's supervision style will affect insurers; and whether insurers can pose systemic risk.

Andrew discussed the PRA's objective to ensure an appropriate degree of protection for policyholders, in particular issues relating to insurers' resolvability and the risks and complexities inherent to some insurance products.

Turning to the new supervisory style, Andrew Bailey said that the PRA will focus on the key risks to its objectives. Andrew illustrated this new approach in the context of insurance with the way the Financial Services Authority has dealt with the delay and uncertainty surrounding Solvency II directive negotiations.

Finally, Andrew Bailey discussed whether some insurers are of systemic importance. Although some insurance firms, including UK ones, are large, complex and highly interconnected, it is not clear at this stage that the appropriate prudential response should be similar to that taken for banks.

Remarks to the London Money Market Association Executive Committee Meeting

Chris Salmon, Executive Director for Banking Services and Chief Cashier, January 2013.

www.bankofengland.co.uk/publications/Documents/speeches/2013/speech632.pdf

In this speech to the London Money Market Association (LMMA) Executive Committee, Chris Salmon provided a progress report on key changes the Bank has been promoting in core sterling money markets.

In unsecured money markets, he highlighted the Bank's ongoing efforts to encourage greater membership of the core high-value payments system, CHAPS; and to address risks from changing payments behaviour, arising from changes to liquidity regulation, through reform of CHAPS 'throughput' rules and the planned introduction of a Liquidity Saving Mechanism in 2013.

In secured money markets, he outlined how the Bank, LMMA, Euroclear UK & Ireland Limited and LCH.Clearnet are promoting the adoption of the 'term DBV' settlement model, whereby term transactions conducted on an overnight Delivery-by-Value (DBV) basis move to a term DBV basis, minimising daily operational and liquidity risks.

Chris Salmon finished by stating that the Bank would welcome the development of London as an offshore centre for renminbi-denominated activity and is ready, in principle, to establish a sterling-renminbi swap line with the People's Bank of China.

Speech by the Governor given at the CBI Northern Ireland Mid-Winter Dinner, Belfast

Sir Mervyn King, Governor, January 2013.

www.bankofengland.co.uk/publications/Documents/speeches/2013/speech631.pdf

In his final regional speech as Governor, the Governor began by noting the challenging prospects for UK economic growth. Growth had been much weaker than expected, reflecting the deep and protracted squeeze on real take-home pay, the impact of bank deleveraging on the willingness by banks to lend, and the intensification of the euro-area crisis.

With a disappointingly slow recovery, the main aim of economic policy over the crisis had been to generate a recovery and a rebalancing of the economy, and to bring unemployment down without putting at risk medium-term price stability. The Bank of England had played its part, via lower Bank Rate, asset purchases, and the Funding for Lending Scheme, which had already eased the availability and price of credit for borrowers.

The Bank would, if needed, do more. But relying on generalised monetary stimulus was not a panacea, and could have undesirable side effects on financial stability. Other policies were also needed. These included measures to fix the banking sector, supply-side reforms to raise future potential supply, and co-ordinated action to help the global economy rebalance.

Looking ahead, the Governor noted that there were good reasons to believe that a gentle recovery was under way. Inflation was set to remain above target for much of 2013 as a result of unusually strong upward pressure from administered and regulated prices. But the Monetary Policy Committee (MPC) could respond flexibly by looking through temporarily higher inflation as long as market-generated inflation pressures remained subdued.

Recent actions by central banks and governments in a number of industrialised countries had raised questions about the framework of monetary policy. The Governor argued that now would be a sensible time to review those arrangements, noting that the Bank's remit did not specify how the MPC should strike a balance between growth and inflation in the short run. In assessing the current framework, however, there were two factors that should not be ignored. First, the primary responsibility of any central bank was to ensure stability of the price level in the long run. Second, the inflation target had not prevented the MPC from combating the recession and was not an impediment to achieving recovery. Instead the challenge we faced was that recoveries from banking crises tend to be protracted.

Monetary policy in a changing economy

Ian McCafferty, Monetary Policy Committee member, January 2013.

www.bankofengland.co.uk/publications/Documents/speeches/2013/speech627.pdf

In his first speech as an MPC member, Ian McCafferty reflected on the changing nature of the labour market, the state-contingency of monetary policy and the risks to the inflation outlook. He argued that part of the weakness of measured productivity stemmed from companies' decisions, in the face of weak demand, to retain staff for their firm-specific skills. As such, the weakness of productivity was cyclical and productivity would recover alongside demand. But the implications for inflation of further monetary stimulus would not necessarily be benign. First, the ability of additional monetary easing to stimulate demand was currently limited by the high level of uncertainty among households and companies. Second, as the recovery took hold, companies may well increase wages in excess of productivity to compensate staff for their restraint of recent years — especially if persistent increases in administered and food prices delayed the fall of inflation back to target this year and next.

Talk to the Economic Club of New York

Sir Mervyn King, Governor, December 2012.

www.bankofengland.co.uk/publications/Pages/speeches/2012/626.aspx

The Governor began by noting the challenging prospects for UK economic growth. Output remained below its pre-crisis peak, and inflation was above target. In the wake of the crisis the budget deficit had risen to 11% of GDP, prompting the authorities to embark on a programme of fiscal consolidation. Monetary policy had played a vital, accommodative role. But economic output had stayed broadly flat, owing in part to a sharp pickup in energy and commodity prices, and the euro-area crisis.

The Governor summarised the Bank's policy responses. The MPC had eased monetary policy further, via its £375 billion programme of asset purchases. In addition, the Bank had introduced the Funding for Lending Scheme, designed to increase the supply of net lending to the real economy. And the Financial Policy Committee had recommended that UK banks and building societies increase their capital in ways that did not hinder lending to the real economy.

The Governor noted that, notwithstanding a number of salient differences between the US and UK economies — including the size of the banking sector, the impact of the housing crisis, and the degree of openness of the economy — the immediate priority for both countries was to continue to rebalance their economies. This implied that other countries would also need to rebalance. The risk was that, in the absence of an agreement between deficit and surplus countries on how best to rebalance the world economy, 2013 could see the growth of actively managed exchange rates as an alternative to the use of domestic monetary policy.

The Governor concluded by identifying a broader challenge we face following the financial crisis. The legitimacy of, and support for, market economies depends on a sense of fairness. The perception that so many people who had benefited little from the upswing had borne the cost of the financial crisis risked undermining support for market economies. Our challenge, in defending the market economy, is to ensure that rewards and opportunities are spread fairly.

Bank share rating: buy!

Robert Jenkins, Financial Policy Committee member, December 2012.

www.bankofengland.co.uk/publications/Documents/speeches/2012/speech624.pdf

In a speech delivered at the ABI annual investment conference, Robert Jenkins portrayed a transformed vision of major global bank behaviour. In this world, bank CEOs, backed by their shareholders, committed to: inviting independent specialists to review valuations; provisioning prudently; abandoning short-term return on equity targets; cutting the share of annual earnings that flowed to employees; and raising any required equity within twelve months. In response, the bank's share price soared, as the market rewarded balance sheet strength, greater transparency, lower volatility and a predictable dividend with a higher earnings multiple.

Household behaviour and policy analysis

Martin Weale, Monetary Policy Committee member, December 2012.

www.bankofengland.co.uk/publications/Documents/speeches/2012/speech623.pdf

In a speech delivered at the New Zealand Economists' Network 2nd Annual Conference, Martin Weale discussed economic modelling and policy analysis with particular reference to the limitations of analysis based on the concept of a representative agent. He focused on disaggregate models which represent the economy as a collection of individual households in different circumstances, and the use of such models to address important policy questions. In particular, he described the way in which such models can be used to address a heterogeneous range of topics: the effects of credit constraints and fears about credit availability; tax structure; social security and pension arrangements; and influences on the take-up of education by mature students. While conceding that these analyses are partial, Martin Weale concluded by reflecting that disaggregated models provide interesting ways of looking at the world, and warned against putting too much weight on findings from analysis based on a representative agent.

Sticky inflation

Spencer Dale, Executive Director and Chief Economist, December 2012.

www.bankofengland.co.uk/publications/Documents/speeches/2012/speech622.pdf

In a speech at Market News, Spencer Dale addressed two issues: the persistence of above-target inflation in the United Kingdom; and the decision to transfer coupon payments from the Asset Purchase Facility to Her Majesty's Treasury.

Spencer Dale expressed his belief that the massive real adjustments required of the UK economy in response to extremely weak labour productivity growth and sharp increases in sterling import prices had been major factors behind the stickiness of inflation. While the extraordinary flexibility displayed by the UK labour market meant that much of the required adjustment in real wages had come about through pay moderation, the sheer scale of this adjustment meant that above-target inflation had been the only alternative to a much deeper recession.

Spencer Dale emphasised that while the transfer of coupon payments did affect monetary conditions in the United Kingdom, so too did many other factors not under the direct control of the MPC. The MPC did, however, have the power to intervene to respond to such developments, and so remained in control of the stance of monetary policy. Spencer Dale also noted that under plausible assumptions much of this transfer would eventually need to be reversed in the future.