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.

Rebalancing

Charlie Bean, Deputy Governor, May 2013.

www.bankofengland.co.uk/publications/Documents/speeches/2013/speech662.pdf

Speaking at the Official Monetary and Financial Institutions Forum, Deputy Governor Charlie Bean considered the imbalances that led to the global financial crisis and reviewed progress in returning to balance. He described three types of imbalance: those within the UK economy, those between eurozone members and those across the global economy. It remained to be seen whether a new balance would be achieved through persistently weak demand in deficit countries, or by stronger domestic demand in surplus countries and a realignment of exchange rates. In part that would depend upon how much damage the crisis had inflicted on economies' supply capacity. It would also depend upon the effectiveness of G20 attempts to co-ordinate economic policies. That process had been hampered because participating countries did not take account of spillovers to other economies. But some aspects had worked well, including the progress made in redrawing the scope of global financial regulation.

A new regulatory relationship: the Bank, the financial system and the wider economy

Paul Tucker, Deputy Governor, May 2013.

www.bankofengland.co.uk/publications/Documents/speeches/2013/speech661.pdf

Paul Tucker reviewed the changing relationship between central banks and the business community. He focused on three facets of the relationship. First, the supervision of the safety and soundness of banks, and the roles of rules and discretion in relation to that. Second, expectations of what the central bank can and should achieve as a macro policymaker, and how society can monitor that role. And third, he considered how the central bank's relationship with the business community plays out in a global setting. Concluding, he said central banks need to be clear about what they can and cannot do: 'we need to operate consistently within our remit; and above all we must be sufficiently transparent to make proper accountability realistic. That is what trust requires, and we are in the business of trust — trust in the value of money'.

The outlook for the UK economy

Paul Fisher, Executive Director for Markets, May 2013.

www.bankofengland.co.uk/publications/Documents/speeches/2013/speech659.pdf

Paul Fisher discussed why the recovery from recession is likely to continue to be prolonged. It is as if the different sectors in society — households, businesses, banks and the government — have decided that their future financial positions (their 'permanent income') on average will be worse than anticipated before the crisis. The process of balance sheet repair will weigh on growth until more of the real adjustments have been made. Paul's best guess was that the United Kingdom is around two thirds to three quarters of the way through that adjustment process, varying both across and within sectors.

One particular reaction to the weaker prospects for income has been for people to price themselves in to work to avoid unemployment. This helps explain why unemployment has stayed lower than expected given the weakness of output growth and why real wage growth has been weak.

He argued that inflation has been above target for several years because of cost shocks, rather than excess domestic demand growth. In his view, if quantitative easing has contributed to inflation being somewhat over target now that was preferable to the alternative of a deeper recession and a greater risk of deflation.

Going forward, monetary accommodation should be helpful to balance sheet rebuilding, but there are limits to the extent that monetary policy can stimulate real growth. In conclusion, Paul said his recent policy votes have been driven by the need to continue supporting the required real adjustments, but cautiously, so as not to risk de-anchoring inflation expectations.

Resolution and future of finance

Paul Tucker, Deputy Governor, May 2013.

www.bankofengland.co.uk/publications/Documents/speeches/2013/speech658.pdf

Paul Tucker outlined the keys steps necessary to further the progress already made by the international regulatory community on the orderly resolution of large and complex financial firms since the crisis. He explained how resolution is essential to solving the problem of 'too big to fail'. Over recent months there has been marked convergence in how the world's key authorities plan to approach resolution. In bringing this to fruition, first, the authorities are going to need to decide how much gone-concern loss-absorbing debt systemically important financial institutions need to have in issue and from which parts of the group. Second, regulation limits on holdings of bank bonds is needed to ensure that the imposition of losses on bond holders does not cause systemic distress through contagion. Third, bespoke restructurings of many financial groups are needed in order to achieve resolvability. Fourth, there is need for clarity about where different types of creditor stand, particularly whether uninsured deposits should rank alongside senior unsecured bonds or whether they should have preferential status. But, in the short term, the most important next step is to finalise the EU resolution directive.

Monetary policy and monetary policy making

Martin Weale, Monetary Policy Committee member, May 2013.

www.bankofengland.co.uk/publications/Documents/speeches/2013/speech656.pdf

In a speech delivered at the British-American Business Council Transatlantic Conference, Martin Weale set out his thoughts on monetary policy making in the current circumstances. He looked at the new remit, in particular the trade-off between controlling inflation and avoiding undue fluctuations in output, and considered how this is currently impacting the actions of the Monetary Policy Committee. He concluded that 'a reasonable trade-off between inflation volatility and output volatility means that, in making our policy decisions, we are very conscious that policy affects output as well as inflation and that periods of below-normal output have very substantial costs associated with them'. However, he also reiterated that a long period of above-target inflation may lead to people losing confidence in the policy: 'Failure to damp sufficiently any new shock pushing up on inflation would result in inflation expectations becoming more entrenched. That, in my view, limits the scope we have to support demand at the current juncture.'

Constraining discretion in bank regulation

Andrew Haldane, Executive Director for Financial Stability, May 2013.

www.bankofengland.co.uk/publications/Documents/speeches/2013/speech657.pdf

In this speech, Andrew Haldane called for an end to self-regulation in the financial sector. He likened banks' use of internal models for determining their capital needs to students marking their own exams.

Since the original Basel Accord in 1993, risk weights have been on a persistent downward trend, while leverage has been on the rise. And the variation between banks is stark: some banks are shown to hold orders of magnitude less capital than their competitors for identical portfolios. Banks have got no better at managing risk, but they have got better at gaming the system. If anything, this has become easier as regulation has got more complex.

This has had a number of unintended consequences: 'red tape' costs to society; unequal regulatory standards between small and large banks; and reduced transparency and increased uncertainty over banks' true capital adequacy. Fortunately, the international regulatory community has slowly begun to recognise and address these problems. Three elements of reform are needed: increased bank transparency, including the Enhanced Disclosure Task Force; imposing floors as a constraint on banks' internal models; and increasing the prominence of leverage ratios as a simpler, more robust metric.

Making greater use of simple, prudent regulatory metrics could restore faith, hope and clarity to the financial system to the benefit of banks, investors and regulators alike.

Forecast errors

Ben Broadbent, Monetary Policy Committee member, May 2013.

www.bankofengland.co.uk/publications/Documents/speeches/2013/speech653.pdf

In a speech to the Mile End Group of Queen Mary, Ben Broadbent explained why a fair assessment of forecasts takes time and cannot be made after a few observations. This is particularly true if economic series are noisy and unpredictable, or if one is trying to predict rare events such as financial crises. Such genuine unpredictability means forecasting errors are unavoidable and may at times be large. Limited information about structural breaks also means that forecasting errors could be serially correlated. Because of these constraints, he argued that forecasters should always be aware of their limitations, and those who judge forecasts less inclined to view each forecast 'error' as a mistake. Instead, forecasters should be continually challenged to improve their techniques. He concluded by pointing out that forecasts — being judgements about future risks — are unavoidable in policymaking, and have a key role in the Monetary Policy Committee's communication to the public.

The new approach to financial regulation

Andrew Bailey, Deputy Governor, May 2013.

www.bankofengland.co.uk/publications/Documents/speeches/2013/speech654.pdf

Andrew Bailey spoke at the Chartered Banker Dinner in Edinburgh regarding 'the new approach to financial regulation'.

In this speech, Andrew spoke about the importance of the services provided by retail banks, and their purpose in supporting activity in the real economy.

Andrew gave an overview of the model for supervision, and how it was important to learn the issues from the past crisis about ensuring the right balance between prudential and conduct supervision. Finally, Andrew spoke about the recommendation of the Bank of England's Financial Policy Committee that the major UK banks, as a group, should increase their equity capital resources. In this context, Andrew explained the objectives of this exercise: to increase the resilience of the UK banking system and to support the creation of credit in the UK economy.

The UK economy: the road ahead?

Ian McCafferty, Monetary Policy Committee member, April 2013.

www.bankofengland.co.uk/publications/Documents/speeches/2013/speech651.pdf

In this speech, Ian McCafferty reflected on the recovery and the role of policy. Ian noted that UK economic growth had disappointed, turning out even weaker than forecast in 2010, although the economy would have fared significantly worse if the Bank had not responded with unconventional easing.

But a number of factors made Ian hopeful for a modest pickup in growth. First, credit conditions were improving, in part due to the Funding for Lending Scheme. Second, there was evidence of an improvement in business sentiment, which would help to support investment. And third, the international outlook was improving.

Ian considered the outlook for inflation to be more concerning. In particular, the combination of a slow recovery with persistent above-target inflation posed a real challenge to the Monetary Policy Committee (MPC). An assessment of the current shocks to inflation showed that it was appropriate to look through them, thus bringing inflation back to target only slowly, and that this was entirely consistent with the MPC's flexible inflation target.

Monetary policy: many targets, many instruments. Where do we stand?

Sir Mervyn King, Governor, April 2013.

www.bankofengland.co.uk/publications/Documents/speeches/2013/speech649.pdf

The Governor began by noting the lessons learnt during the crisis about the objectives of monetary policy. The crisis had shown that financial vulnerabilities could build even while output was growing steadily and inflation was low and stable. That meant that macroeconomic policy could face an additional trade-off between ensuring the soundness of the financial system in the medium term, and keeping output in line with potential output and inflation on target in the near term.

The Governor went on to reflect on the role of central banks and challenges to central bank independence. Despite there being limits to what they could achieve in current circumstances, central banks had taken extraordinary measures in response to the crisis. Such measures could risk moving into territory more usually associated with fiscal policy and, in doing so, put at risk hard-won central bank independence.

The Governor noted three threats to central bank independence. First, there was the risk of appearing to promise too much, or allowing too much to be expected of central banks. Second, at the zero lower bound there was no clear distinction between monetary and fiscal policy. And third, the discharge of new responsibilities for macroprudential policy, and in the case of the Bank of England, microprudential regulation, could not be divorced from the government in the same way as is possible for monetary policy.

In responding to this more complex post-crisis environment, central banks should keep sight of three important principles. First, it was right that elected politicians and parliaments should decide on the objectives of policy. Second, if the central bank was to achieve price stability, it needed to be sufficiently independent. And third, in order to protect that independence, its limits should be very clearly circumscribed and central banks should be exceptionally careful with decisions that put public funds at risk. The challenge remained to make 'constrained discretion' work in practice.

Inflation, employment and monetary policy in the United Kingdom and the United States

David Miles, Monetary Policy Committee member, April 2013.

www.bankofengland.co.uk/publications/Documents/speeches/2013/speech647.pdf

In a speech delivered at the 2013 Economic Conference of the Federal Reserve Bank of Boston, Professor Miles considered how significant might be the differences in central banks' objectives in shaping monetary policy. He discussed differences in the remits of the Federal Reserve, which explicitly has a dual mandate targeting both inflation and employment, and of the Bank of England, which does not. He argued that in the current economic environment, monetary policy may be rather insensitive to the way in which a central bank's objectives over growth and employment sit alongside an inflation target. With the help of an economic model, Professor Miles concluded that a wide range of weights placed on real variables — output and employment — in the central bank's objectives can today give rise to rather similar monetary policies. In his view this explained 'why the Fed and the Bank of England, two central banks with rather different formal objectives, have set monetary policy in such similar — and extraordinary — ways'.

Turning the red tape tide

Andrew Haldane, Executive Director for Financial Stability, April 2013.

www.bankofengland.co.uk/publications/Documents/speeches/2013/speech646.pdf

In these remarks, Andrew Haldane drew parallels between regulatory and legal frameworks. He highlighted the path dependence of such complex, evolutionary systems and suggested that they sometimes resulted in suboptimally complex outcomes.

Financial regulation has been shaped by events through history and the cumulative consequence of each response is a steadily rising tide of red tape and regulation — an increasingly complex rulebook. Maintaining such frameworks is a high-cost activity and they tend ultimately not to solve the problems for which they were a response. Evidence from the tax code suggests that in filling old cracks, complex rulebooks may in fact increase the likelihood of new loopholes emerging. Moreover, complex regulatory frameworks tend to be inequitable. This is why big banks typically hold far less capital than smaller banks.

In the light of the financial crisis, there are signs of the red tape tide beginning to turn in the area of financial regulation. Tax reform has been successful when it has started simple and afresh, rather than removing layers of complexity one at a time. Financial regulation is no different.

Inflation and growth: what role for monetary policy?

Spencer Dale, Executive Director and Chief Economist, March 2013.

www.bankofengland.co.uk/publications/Documents/speeches/2013/speech643.pdf

In a speech to the Asian and Chinese Business Associations of the London Chamber of Commerce, Spencer Dale discussed the flexibility of monetary policy in the United Kingdom to support growth and employment as well as to control inflation.

Spencer cited the extraordinary monetary stimulus imparted by the MPC over recent years, in the context of rates for CPI inflation that have typically been above the mandated 2% target, as evidence that the Committee has gone to great lengths to support output growth. This was entirely consistent with the remit given to the MPC by the Government. But such flexibility was only possible while the MPC's commitment of returning inflation to target was credible. A focus on price stability therefore remains as important as ever.

Spencer went on to explain why he is wary of arguments for why additional demand stimulus may not have much effect on inflation at present.

Nominal income targets: an old wine in a new bottle

Charlie Bean, Deputy Governor, February 2013.

www.bankofengland.co.uk/publications/Documents/speeches/2013/speech640.pdf

Speaking at the Institute of Economic Affairs State of the Economy Conference, Deputy Governor Charlie Bean considered the arguments for and against a nominal income target. Given how inflation targeting had operated in practice, he suggested that nominal income growth and inflation targets generated similar responses to both aggregate demand and aggregate supply shocks. The main difference between the two related to communication. Targeting the level of nominal income would, however, involve rather different policy settings to an inflation target. Such a target may be a useful way to influence expectations, but its merits were less clear in the presence of negative supply shocks. Moreover, it meant tolerating periods of higher-than-normal inflation and risked generating financial imbalances. He concluded that it was sensible to review the monetary framework from time to time, but there was a danger in expecting too much from monetary policy.

Current issues in monetary policy

Paul Fisher, Executive Director for Markets, February 2013.

www.bankofengland.co.uk/publications/Documents/speeches/2013/speech639.pdf

Paul Fisher explained the role of the Bank of England's balance sheet in enabling it to deliver its core functions. The ability to control the amount of narrow money in the economy, and/or its price, is the fundamental tool the Bank has to implement monetary policy. He also noted that the Bank can influence the supply and price of credit. For example, by acting as 'market maker of last resort', it has supported the commercial paper and corporate bond markets. But the power to intervene is one to use cautiously given the risk of creating distortions.

Paul said he did not believe that quantitative easing is noticeably less powerful than previously. Having voted for a £25 billion extension of asset purchases at the February 2013

MPC meeting, he thought that could be the first instalment of a more prolonged run of purchases, which could be accelerated or stopped as the economic outlook developed.

On the Funding for Lending Scheme, he said that the first stage — cutting banks' funding costs — had been remarkably successful. The next stage — lower funding costs feeding through to lower borrowing rates — was also happening. The final stage — increases in the quantity of credit — would take time to work through from applications to approvals to actual lending. The eventual impact will depend on credit demand and the creditworthiness of borrowers.

Although such policies can help provide the foundations for growth by easing the path for necessary real adjustments, ultimately growth will depend on real factors such as expectations of real income and productivity.