Bank of England speeches

A short summary of speeches and *ad hoc* papers made by Bank personnel since 1 December 2013 are listed below.

The transition to a new normal for monetary policy

David Miles, Monetary Policy Committee member, February 2014.

www.bankofengland.co.uk/publications/Documents/speeches/2014/speech707.pdf

David Miles argued that the 'neutral' level of Bank Rate will probably be below its long-run average of 5% for some time to come. He defined the neutral rate as the level of Bank Rate which, once inflation is at target and output in line with potential, keeps the economy there on average. It could be seen as the sum of the rate of return on safe, inflation-proof assets and the inflation target.

Miles argued that the rate of return on safe assets would remain lower, and the spreads on risky assets higher, in the years to come than before the crisis: 'Households, firms, and investors now attach a higher probability to financial crises and sharp, prolonged downturns in economic activity: events that many may have thought close to inconceivable. This makes assets which generate a real return with little risk more attractive, driving down the real risk-free interest rate'. He estimated that the neutral level of Bank Rate might fall to around 3%. Miles did not believe that the composition of the Bank of England's balance sheet would materially affect this estimate.

The UK economy and the world economy

Ben Broadbent, Monetary Policy Committee member, February 2014.

www.bankofengland.co.uk/publications/Documents/speeches/2014/speech708.pdf

In a speech at the Institute of Economic Affairs State of the Economy Conference, Ben Broadbent discussed the relationship between UK and global growth. He stressed the importance of developments in the global economy and international capital markets for both short-run domestic demand and economic performance over longer horizons. Over the short term, international factors beyond the direct effects from trade have a substantial impact on domestic demand, perhaps reflecting the greater integration of capital markets. This can be beneficial, when country-specific risks are shared more widely, but can also be damaging if greater financial interconnectedness creates or amplifies risks. Over the longer run, Ben discussed evidence which indicates that greater openness allows countries to converge more quickly to higher levels of productivity. He suggested that this could be driven by open capital markets which allow countries to tap other sources of finance, or international investment bringing with it intangible benefits. He concluded that, on balance, the UK economy is likely to benefit from its exposure to the world.

The economics of currency unions

Mark Carney, Governor, January 2014.

www.bankofengland.co.uk/publications/Documents/speeches/2014/speech706.pdf

The Governor provided a technocratic assessment of what made an effective currency union between independent nations — having noted that any arrangement to retain sterling in an independent Scotland would need to be negotiated between the Westminster and Scottish Parliaments, and that the Bank of England would implement whatever monetary arrangements were put in place.

The success of a currency area hinged on whether its features mitigated the costs of losing the flexibility that came from an independent monetary policy. These features generally promoted the alignment of economic cycles, and the maintenance of price and financial stability within the union.

The ingredients of a successful union included mobility of labour, capital and goods; institutional structures promoting financial stability (a 'banking union'); and institutions that mutualise risks and pool fiscal resources.

The risks arising from the absence of these foundations had been demonstrated clearly in the euro area over recent years, with sovereign debt crises, financial fragmentation and large divergences in economic performance. The euro area was now beginning to rectify its institutional shortcomings, but further, very significant steps were necessary to expand the sharing of risks and pooling of fiscal resources. In short, a durable, successful currency union required some ceding of national sovereignty.

It was likely that similar institutional arrangements would be necessary to support a monetary union between an independent Scotland and the rest of the United Kingdom.

Decisions that cede sovereignty and limit autonomy were rightly choices for elected governments and involved considerations beyond mere economics. For those considerations, others were better placed to comment.

Remarks given by Mark Carney, Governor, at the Davos CBI British Business Leaders Lunch, Switzerland

Mark Carney, Governor, January 2014.

www.bankofengland.co.uk/publications/Documents/speeches/2014/speech705.pdf

The Governor discussed the prospects of the global and British economies achieving escape velocity — the momentum necessary for an economy to escape from the many headwinds following a financial crisis. Although the global economy had picked up over the previous year, and tail risks had decreased, it would take sustained growth, more balanced demand and a recovery in the supply side for advanced economies to break free into a more normal universe.

The Governor noted that the global economy had been in similar circumstances before. In the aftermath of the Great Depression, demand was persistently weak because policy mistakes were legion. This time, thus far, was different. Protectionism was being resisted, banks recapitalised, and the global financial system rebuilt. In parallel, monetary policy remained exceptionally stimulative.

Staying the course on these policies would be decisive to achieving escape velocity. As the leading global financial centre, the United Kingdom was central to building a more resilient, open global financial system, setting the stage for monetary policy to support a supply-side recovery.

Given the surprisingly poor supply-side performance and the considerable, uncertain slack in the economy, it made sense for monetary policy to test the extent to which supply performance was 'endogenous' to demand. This was one of the main advantages of the Bank's forward guidance policy. Though there were several reasons to expect productivity growth to pick up as the recovery proceeded, unemployment remained above the level that was likely to be consistent with maintaining inflation at the target in the medium term, which suggested that the recovery had some way to run before it would be appropriate to consider moving away from the emergency setting of monetary policy.

The Monetary Policy Committee had noted that when the time eventually came to begin to move away from emergency settings of policy, any such move would be gradual. The Bank's assessment of how to evolve guidance to changing circumstances would begin in its February *Inflation Report*.

Inflation, interest rates and forward guidance

Paul Fisher, Executive Director for Markets, January 2014.

www.bankofengland.co.uk/publications/Documents/speeches/2014/speech704.pdf

Paul Fisher highlighted the importance the Monetary Policy Committee (MPC) attaches to inflation being back close to its 2% target. He explained that although inflation is costly for many reasons, it had been appropriate not to have tighter monetary policy in recent years, as the sources of the inflationary pressure were not persistent and tighter policy would have led to the threat of deflation and depression.

Since the introduction of forward guidance, unemployment had fallen unusually precipitously. Although welcome, he stressed that in order to see rising living standards on average it is crucial to see rising productivity too. Looking ahead, price pressures seemed to be subsiding and inflation expectations remained well anchored. The MPC therefore had a favourable situation in which to explore how much more capacity the economy has, before inflationary pressures begin to build.

Against this backdrop, Paul explained that even if the 7% unemployment rate threshold were to be reached in the near future, he saw no immediate need for a tightening of policy and that when it is time, it would be appropriate to do so only gradually.

Achieving a sustainable recovery: where next for business investment?

Ian McCafferty, Monetary Policy Committee member, January 2014.

www.bankofengland.co.uk/publications/Documents/speeches/2014/speech703.pdf

In this speech, Ian McCafferty reviewed the factors likely to underpin a recovery in UK business investment over the next 12–18 months. Setting the recent weakness of business investment in a historical context, he argued that investment is a late, but essential, contributor to economic recoveries. Two main factors have depressed business investment since the crisis: low confidence/heightened uncertainty and adverse financing conditions. The ongoing decline of uncertainty is a prerequisite for any recovery in business investment. And improving financing conditions are making possible the realisation of investment plans — first to replace equipment, but also to expand capacity and, in time, keep up with competitors. While large firms rely on bond markets and the smallest firms have only limited recourse to bank finance, mid-size firms have yet to benefit from easier bank credit. But they rely heavily on internal funds and should gain from waning pension deficits as yields rise.

The balance of growth

Ben Broadbent, Monetary Policy Committee member, January 2014.

www.bankofengland.co.uk/publications/Documents/speeches/2014/speech702.pdf

In a speech at the London School of Economics, Ben Broadbent addressed concerns that the composition of the recent recovery in UK output growth might make it unsustainable. According to an oft-cited view, the pickup in consumer spending will subside as real wages remain weak, while perpetually stagnant business investment will fail to compensate for that eventual slowdown in household consumption. He first explained that the decline in real wages during the previous recession was not due to a rise in firms' profit margins but to higher inflation in consumer relative to output prices. Next, he showed that business investment lags rather than leads near-term output growth. Other imbalances in expenditure or income are also poor predictors of future growth. He concluded that other factors such as relative prices, foreign demand and UK productivity growth are more likely to determine how sustainable the UK recovery proves to be.

The Commercial Property Forum twenty years on

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

www.bankofengland.co.uk/publications/Documents/speeches/2013/speech701.pdf

In this speech, Andrew Haldane celebrated the 20th anniversary of the Bank's Commercial Property Forum. Historically, commercial property has been highly procyclical. Over the past century, the UK commercial property market experienced five distinct boom-bust cycles. The Bank's Commercial Property Forum was itself born out of the commercial property crash of the early 1990s.

The industry recognises the need for change. Recent proposals by the industry to base lending decisions not on spot, but medium-term or sustainable valuations are one way of slowing that procyclical spiral. Regulatory change is needed too. The deep and lasting impact of the credit cycle has shown that we need to take prompt and corrective action to lean against financial swings.

In the United Kingdom, that task of leaning against procyclicality in the financial system falls to the Bank's new Financial Policy Committee. And recent policy actions by the authorities to reduce the stimulus to the mortgage market are a sign of this big philosophical shift.

The United Kingdom's economic recovery: why now; will it last; and what next for monetary policy?

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

www.bankofengland.co.uk/publications/Documents/speeches/2013/speech698.pdf

Speaking at the Confederation of British Industry Midwinter Lunch, Spencer Dale addressed three questions about the UK recovery: why now; will it last; and what next for monetary policy?

The improved availability of credit had helped support a recovery, in part by fostering a thawing in the housing market. A healthy housing market was important for the UK economy, although the Bank would remain vigilant for it heating up and would be far better equipped to respond should this happen than in the past.

Spencer contended that a reduction in uncertainty may have been more important still in driving a pickup in growth, as companies in particular exit from a strategy of survival and hunkering down and start to pursue risky, but productive and profitable, ventures.

Despite these reasons for optimism, some effects of the crisis may persist, for example a reluctance of some companies to depend on bank credit. Although understandable, such behaviours may hamper the efficient functioning of the economy.

On policy, and in the context of the MPC's policy guidance, Spencer emphasised that the economy faced a long road back to normality, and that this would not be brought about by a couple of quarters of strong growth.

Solvency II — a turning point

Julian Adams, Deputy Head of the Prudential Regulation Authority and Executive Director of Insurance, December 2013.

www.bankofengland.co.uk/publications/Documents/speeches/2013/speech699.pdf

In a speech given to representatives from the insurance industry at the Prudential Regulation Authority's (PRA's) offices in London, Julian Adams set out what recent policy developments meant for the implementation of Solvency II in the United Kingdom. Julian's speech centred on the work that needed to be completed by the PRA and insurers to be ready for the new regime on 1 January 2016, based on the preparatory guidelines issued by the European Insurance and Occupational Pensions Authority. As the speech supported the publication of Supervisory Statement 4/13, Julian highlighted particular areas of the Statement before relating the PRA's expectations of insurers. Julian referred to the initiatives in insurance supervision — more immediately in Solvency II and also the upcoming work of the International Association of Insurance Supervisors — and the imperative for insurers to stay abreast of policy developments.

Forward guidance and its effects

Martin Weale, Monetary Policy Committee member, December 2013.

www.bankofengland.co.uk/publications/Documents/speeches/2013/speech697.pdf

In a speech given to the National Institute for Economic and Social Research, Martin Weale explained some of the theoretical issues around forward guidance and offered his initial thoughts on what its impact had been. He used a simple New Keynesian framework to explore the effects of forward guidance, which pointed to the strongest impact of the policy being at the start of the period of forward guidance. To investigate this impact, Martin first looked at market rates. He said he saw no obvious impact on expected future rates immediately after the announcement of forward guidance — although he noted that the discussion of forward guidance prior to August may have already been reflected in market expectations. Next, Martin turned to an analysis of the impact on uncertainty. Studying the volatility of Libor options, he found that the policy appears to have brought about a marked reduction in uncertainty at the shorter end of the market, at around three to six months.

The spirit of the season

Mark Carney, Governor, December 2013.

www.bankofengland.co.uk/publications/Documents/speeches/2013/speech696.pdf

The Governor started by noting that a recovery was gaining pace in the United Kingdom, underpinned by a reduction in extreme uncertainty, significant progress in repairing the core of the financial system and a marked improvement in household balance sheets. The question was whether such progress was sufficient for a durable, strong and balanced recovery over the medium term.

The Governor considered two possible explanations for why advanced economies could have entered a low-growth phase. First, on the demand side, a persistent liquidity trap, making it difficult for resources to be fully utilised, and second, a persistent deterioration in the supply side such that full utilisation of resources was consistent with slower growth.

The Governor argued that, although the United Kingdom had been in a situation in which conventional monetary policy had not been able to stimulate demand sufficiently to keep economic activity at its potential level, this had not generated a deflationary spiral and there was early evidence that this 'liquidity trap' would be escaped over time.

The Governor also challenged those who maintained that weak potential supply growth would constrain the pace of recovery. While the United Kingdom's experience did not rule out the possibility that supply growth had slowed, the nature of the slowdown, particularly in the labour market, suggested that supply would likely increase with demand for some time.

The risks to supply and the risks associated with the liquidity trap meant that central banks needed to deploy a wide range of policies in a co-ordinated fashion. Forward guidance would continue providing reassurance that monetary policy would not be tightened prematurely. The synergies of combining the monetary and macroprudential authorities in one institution would also be considerable — by addressing risks to financial stability, the Bank's Financial Policy Committee was helping to ensure that monetary policy would remain as stimulative as necessary. The third aspect of the policy response was better financial regulation and supervision — supporting a transparent, resilient global financial system, and the rebalancing of the global economy. Nevertheless, the most important drivers of long-term prosperity would be measures taken by others to increase the growth of supply, particularly those that reinforced an open, global economy.