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Speech

Speech given by

The Rt Hon Sir Edward George, Governor of the Bank of England

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Thank you Padraic for that kind introduction and for honouring me with the Euromoney Lifetime Achievement Award. It's nice to be prompted to recall some of the good times – and some of the not so good times in the course of my career at the Bank of England which I think of not so much in terms of achievement but of lifelong learning.

We've come a long way since 1962 – both nationally and internationally – from different starting points certainly, and moving in fits and starts, at varying speeds and to varying degrees, in a process of continuing, indeed accelerating, change. But standing back and trying to look through the confusion of short-term events, I would pick out three broad trends for comment this morning.

The first relates to macro-economic policy, where the earlier emphasis was very much on short-term demand management designed to manage the perceived trade-off between growth and employment, on the one hand, and inflation and a manageable balance of payments position, on the other. Monetary policy was used in conjunction with fiscal policy and supported with various forms of direct control to pump up demand, when the economy declined and unemployment rose, until inflation and the balance of payments threatened to get out of hand, at which point all the policy levers were thrown into reverse. It was a recipe for short-termism throughout our economies.

We gradually learned from experience – perhaps more slowly in this country than some others – that there is no trade-off between growth and stability in the medium and longer term, and that, in managing demand – which of course we continue to do – we needed to pay far more attention to the underlying, supply-side, capacity of the economy to meet that demand. We came to recognise that direct controls merely addressed the symptoms of instability rather than its causes. We realised increasingly that fiscal policy was not well suited to the task of short-term demand management, and needed to be constrained within prudent limits if debt levels were to be sustainable in the medium- and longer-term. And this left a more distinctive and clearly defined role for monetary policy as the primary instrument for maintaining broad balance consistently over time between aggregate demand and underlying supply.

All this has become the accepted wisdom just about everywhere. "Stability is a necessary condition for sustainable growth" has become the universal central-banking credo – though that doesn't necessarily make it any easier to achieve!

This emphasis on macro-economic stability - and sustainability - has served to focus attention increasingly on the supply-side of our economies – on structural reform and supply-side flexibility – as the key to raising the underlying rate of growth which our economies can maintain. And that is the second general trend I'd like to touch upon.

It has meant increasing reliance upon free markets – again both nationally and internationally – to allocate productive resources to where they can most effectively contribute to meeting demand. The collapse of communism is a dramatic example, but the promotion of free trade through the WTO and of the free movement of capital

through the IMF, or the spread of privatisation and deregulation all around the world, not least in financial markets, can all be seen as aspects of essentially the same thing.

This emphasis on free markets cannot mean “anything goes”. Public policy concerns, of course, remain; and we need to have rules to ensure that competition is fair as well as free. But it does mean less centralised, bureaucratic, intervention telling people what they may or may not do, leaving them much greater freedom to do what they choose provided they meet the necessary nationally or internationally agreed standards. The resulting intensification of competition can, of course, be uncomfortable for existing producers – and can lead to protectionist pressures at the micro-economic or even the national level – so we still have a long way to go. But it is increasingly accepted as the best means we have raising the sustainable rate of growth – and employment – and living standards - at the macro-economic, and international, level.

These trends together have resulted in substantial economic progress in most of the developed economies. But – and this is the third theme I would draw attention to this morning – there was growing recognition of the fact that not all countries were equally well-placed to share in the potential benefits of free markets within a stable macro-economic framework, and of the need – as a matter of self-interest and not just social responsibility – to help draw other countries in to the global economy. Emerging markets and transition economies have increasingly gained access to international capital markets. And there is an increasing emphasis on the need to help the poorest countries that are seeking to help themselves to participate. This last concern will be on the agenda of the Monterrey conference next month.

Now, all of these developments have had – and will continue to have – enormous influence on the evolution of the financial environment, including bond markets internationally.

Monetary stability has brought a sustained decline in nominal government bond yields in industrial countries, and a narrowing of yield differentials, which was inconceivable during much of the earlier part of my working life. And fiscal prudence has brought not just a proportional, but in some countries an absolute, decline in the amount of private savings absorbed by government debt. That has left room for a rapid expansion and diversification of the corporate debt market to accommodate increasing demand, as the role of the private sector has increased. And the sovereign debt market, too, has diversified to include those emerging markets and transition countries that have succeeded in accessing the increasingly free international flow of capital.

These are big, long-run, changes which, are for the most part likely to continue. So your job – as investors and investment managers, won’t get any easier!

I have the impression that the investing public is still coming to terms with the lower nominal returns that they can expect if we really are in a world of sustained low inflation. So they may be demanding quite a lot from you.

It’s true that in an environment of sustained monetary stability you might not see the very large and unpredictable swings in interest rates that I grew up with. I don’t suggest that that interest rate risk will go away altogether – though if I could make just one comment on the current macro-economic situation you’ll be discussing in a moment, it would be to caution you against placing too much weight on the steepness of the short-term interbank interest rate futures curve as an indicator of the likely

course of official short-term interest rates – at least in the UK: our impression is that it includes quite a significant term premium. But even if interest rates are some degree less volatile, in a context of overall monetary stability, we certainly won't avoid sectoral imbalances such as we have seen over the past year or so; nor can we exclude policy failures in individual countries, which can, as we saw in the Asia crisis but happily not in the present case of Argentina, have wider repercussions. So I suspect you will have your work cut out in pricing and managing credit risk in your necessarily more diversified bond portfolios.

You have a difficult job. But the efficiency with which the market allocates financial resources depends upon your doing it well. It is a heavy responsibility.

But the official community equally has a responsibility to help in so far as it can. And we can help, I think, in three main ways.

The first is through transparency in our macro-economic policies – in the provision of reliable data, and through clarity in both our monetary and fiscal objectives, in our analysis and in our decision-making, so that you are not exposed to wholly unpredictable behaviour and can make your own considered judgements as to how far our policies are likely to succeed. Your judgements, of course, can in turn have an important bearing on our policy decisions.

Secondly we can help in providing robust infrastructures – and I have in mind not just the financial infrastructure, though sound financial systems are clearly hugely important, but much more widely the legal framework, accounting and disclosure standards, and governance structures, for example, as they apply throughout the private sector, so that again you can base your assessment of corporate credits on a fuller understanding of the risks. We have been making very considerable efforts in different international fora in recent years to establish codes and standards of best practice in all these areas which can be universally applied, but I don't need to remind you how far we all still have to go.

And thirdly, in relation to sovereign debt, I think that the international community could, and should, do more to clarify the scale of official support that a country running into difficulties might reasonably look for, and the kind of conditions that it might expect to apply. As things stand at present neither the debtor countries nor their private sector creditors have much idea what to expect, and may be tempted to assume that they will be bailed out if things go wrong. Greater clarity could help to persuade borrowers to face up to hard policy choices earlier, before things get out of hand, and enable the creditors to make a more objective assessment of the risks. I think, too, that it would be helpful if we could at least agree on best practice guidelines for a debtor country's handling of a situation in which it could not immediately honour its obligations. That, too, could help creditors better understand the risks that they are taking on.

But while the official community can help in these ways, in the final analysis the buck stops with you, the investors. I find it encouraging that so many of you are attending this conference, at which many of the relevant risks, and how they can be measured and managed, will be discussed. I'm very tempted to remain with you for your discussions, but sadly I have my own job to do, which makes it impossible for me to stay.

But I wish you, Padraic, and everyone here an enjoyable and interesting couple of days in what has become the best tradition of this very special event.