



BANK OF ENGLAND

# Speech

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Speech given by

Mervyn King, Governor of the Bank of England

At the Lord Mayor's Banquet for Bankers and Merchants of the City of London at the  
Mansion House

16 June 2004

## MANSION HOUSE SPEECH, 16 JUNE 2004

My Lord Mayor, Mr Chancellor, My Lords, Aldermen, Mr Recorder, Sheriffs, Ladies and Gentlemen:

Not since 1881 has a new Governor ceded over six years seniority in office to the Chancellor of the Exchequer – when Gladstone had eleven years advantage over Grenfell. So I approach tonight with due humility, and offer my congratulations to the Chancellor for his longevity in office and successful pursuit of economic stability – not even Gladstone achieved such stability. A major contribution to that was made by my predecessor. I want to express the gratitude of the Bank to Eddie George for his leadership and my thanks for his personal support during his ten years as Governor, which historians will surely describe as a golden period for the Bank.

You will all know that today is the centenary of "Bloomsday". Leopold Bloom's walk around Dublin, immortalised in James Joyce's *Ulysses*, was on 16<sup>th</sup> June 1904. Joyce himself wrote "I've put so many enigmas and puzzles [in the book] that it will keep the professors busy for centuries arguing over what I mean". Some might say that Joyce invented the language of central bankers!

Tonight I want to describe a different walk – the Governor's walk. Initiated by Montagu Norman, from Notting Hill Gate to the Bank of England, it is a walk through the British constitution. Starting in the "dignified" branch of the constitution, to use Walter Bagehot's word, near Kensington Palace it continues through the Royal Parks towards the "efficient" part of the constitution: the Executive. Up the Clive Steps, and navigating carefully between the Foreign Office and the Treasury, of which the Bank has long experience, I look up at the Chancellor's window and see those famous golden scales which balance spending, on the one hand, and revenues, on the other. Recently they have tilted more and more towards the spending side, although the projected rise in tax revenues over the next three years will, I am assured, allow the scales to swing back to what is known in the trade as a sustainable fiscal position. That is important because the improvement in the fiscal stance in recent years has been a key element in achieving macroeconomic stability.

I move on towards the third branch of the constitution: the Legislature. Passing through Parliament Square, I recall my four appearances before the Treasury Committee over the past year: a key part of our public accountability. Such hearings are a far cry from the days when a previous Deputy Governor said to a Parliamentary Committee, “it is a dangerous thing to start to give reasons”. The Bank of England has now raised interest rates four times since November. Although UK interest rates have been the highest in the G7 for well over three years, alone among the G7 we have not experienced a single quarter of falling output for over a decade. Indeed, it is the relative strength of the UK economy that explains those differences in interest rates. But a synchronised recovery in the rest of the industrialised world is now underway. The US economy has created over one million jobs this year. Even in the euro area and Japan, where domestic demand has been weak, growth in the first quarter was the fastest for several years. As a result, the world interest rate cycle has now turned. Over the past three months expectations of interest rates among all the major industrial countries have risen as recovery has become more firmly established.

But what are the prospects closer to home? A reasonable **central** view is that UK growth is likely to be robust over the next year, and then to ease back towards its long-term average. As far as we can tell, there does not appear to be much spare capacity in the UK economy. The labour market has tightened further as employment has risen at well above the rate implied by growth of the labour force. Cost pressures are increasing, and pay growth has picked up.

There are, of course, many uncertainties and risks around that central view. How far interest rates will need to rise in order to keep inflation on track to meet our 2% target for CPI inflation in the medium term is impossible to say with any degree of confidence. But the MPC will continue to remain focussed on meeting the inflation target in order to deliver stability.

Having satisfied, I hope, the requirement to explain our monetary policy decisions, the Governor’s walk now crosses Westminster Bridge, continues down the South Bank and over that other monument to stability, the Millenium Bridge. I enter the City after six miles of virtually traffic-free walking, and arrive in the calm atmosphere of the Bank of England. Over the past year, the Bank has been able to reflect on the

changes stemming from the Bank of England Act 1998 and the associated Memorandum of Understanding between the Bank, Treasury and FSA on financial stability. That legislation inevitably changed the Bank's relationship with the City and the financial sector more generally. Freed from the responsibilities of day-to-day regulation, the Bank has been able to focus on two principal objectives: maintaining monetary stability and maintaining financial stability. Those objectives are the essence of central banking. But that left hanging in the air the question of the Bank's traditional role in the City. That role has evolved over many years, and the recent changes provide an opportunity to restate how we see it.

Since Big Bang in 1986, the City has changed beyond all recognition. The so-called "Wimbledonisation" of the City – hosting a successful tournament where most of the winners come from overseas – has proceeded apace. Some have blamed the Bank, among others, for failing to engineer the promotion of more British institutions to the top ranks of global financial institutions. But in fact there are now some home players in the top ten in the world. And there is little evidence that it makes sense for the public sector to try to identify national champions, as opposed to creating an environment which encourages innovation and provides first-rate infrastructure.

The Bank is, and always will be, deeply involved with the City and those who work here. We operate in markets daily; we stand at the centre of – indeed underpin – the payments system; we have a close interest in settlement systems. But our involvement is from the perspective of the public interest, not the defence of particular private interests nor treading on the toes of other public authorities. At present there are three areas in which we are looking actively to work with practitioners to improve both our performance and the efficiency of the financial markets in London.

First, the Bank tries to detect and reduce threats to the stability of the financial system as a whole – work led by Sir Andrew Large, Deputy Governor for Financial Stability. To help us do that we have expanded our market intelligence function, under Paul Tucker, the Executive Director for Markets. The risks to financial stability now come at least as much from lack of liquidity in markets as in individual institutions. So the eyes and ears of the Bank need to be sharper than ever. That is why the Bank

remains, to quote Governor Cobbold in 1958, “a bank and not a study group”, and I have encouraged staff in the Bank to learn as much as they can from outside Threadneedle Street and not just from the files or computers inside. With so much information and so many players in the City today, it is no longer sensible to define the relationship between the Bank and the City solely through the person of the Governor. The relationship must be broader and calls for a high degree of personal contact. That is why I appointed Alastair Clark as Advisor to the Governor on financial sector issues last summer, and this expanded line of communication has proved immensely valuable in drawing to our attention the nature of issues about which you in the City are concerned.

Second, as I announced last October, the Bank has decided to reform the way it conducts operations in the sterling money markets. The present system is complex and results in volatile overnight interest rates. At the very short end, market rates are distorted when changes in the official rate are expected at the subsequent MPC meeting. We are considering two alternative ways of conducting operations – one with banks settling their accounts each day and the other based on an averaging scheme for bank reserves. Either approach would represent a significant improvement to the current system. Both would extend to a wider set of banks access to the deposit and lending facilities we offer. We will consider carefully the views expressed to us in response to the consultation paper published in May, and will shortly be announcing the direction in which the system will change. I want the Bank to become a model of how to conduct monetary policy operations.

Third, the technology for payments is constantly evolving. And central bank practices need to evolve with it. So just as widening access to our market operations will improve the functioning of sterling money markets, so widening access to the UK large value payment system can lead to safer and more efficient payments. The introduction of real time gross settlement reduced interbank credit risk for payments made between banks in the CHAPS system by removing the gap between final payment and receipt of funds. Wider membership of CHAPS might permit a further reduction in that risk and make our financial system more resilient in a crisis. Our intention is to understand better what are the barriers to wider membership and how they can be lowered. Separately, in the area of retail payments, it is disappointing that

the UK now takes longer to clear payments – whether cheques or electronic payment – than almost any other member of the G10. Together with other members of the OFT task force, the Bank will actively explore ways in which that performance can be improved.

My Lord Mayor, you did ask me whether I could talk about something more interesting at the Mansion House Dinner, such as the City's commitment to the Arts. If you feel like that, I replied, why don't we go to the Barbican on 16<sup>th</sup> June to hear Bernard Haitink conduct Brahms's Third and Fourth Symphonies? I was sure we could get back to Mansion House before it was our turn to speak. Dutiful as ever you counselled against this course of action. But your personal commitment to the arts, and to music in particular, has been the centrepiece of your Mayoralty. Your campaign for "Music and the Arts for Everyone" has happily coincided with the centenary of the London Symphony Orchestra which, so ably led by Clive Gillinson, is a demonstration of what the City and the arts can achieve in partnership which helps to make London such a wonderful city in which to live and work ... and indeed walk. And tonight all of us here would like to pay tribute to your work, and to thank both the Lady Mayoress and yourself for the splendid hospitality which you have extended to us all this evening.

So I invite you all to rise and join me in the traditional toast of good health and prosperity to "The Lord Mayor and the Lady Mayoress".

ENDS